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2717 No. 13139

**United States
Court of Appeals**
for the Ninth Circuit.

NATIONAL LABOR RELATIONS BOARD,
Petitioner,

vs.

INTERNATIONAL ASSOCIATION OF HEAT
AND FROST INSULATORS AND ASBES-
TOS WORKERS, LOCAL No. 7, A.F.L.,
Respondent.

Transcript of Record

**Petition for Enforcement of Order of the
National Labor Relations Board**

FILED

FEB - 6 1952

No. 13139

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National Labor Relations Board**

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

A. NORMAN SOMERS,
Assistant General Counsel,
For the Petitioner.

L. PRESLEY GILL,
2800 First Ave.,
Seattle, Washington,
For the Respondent.

Form NLRB-508

United States of America
National Labor Relations Board

CHARGE AGAINST LABOR ORGANIZATION
OR ITS AGENTS

Important—Read Carefully

Where a Charge Is Filed by a Labor Organization or an Individual or Group Acting on Its Behalf, a Complaint Based Upon Such Charge Will Not Be Issued Unless the Charging Party and Any National or International Labor Organization of Which It Is an Affiliate or Constituent Unit Have Complied With Section 9 (f), (g), and (h) of the National Labor Relations Act.

Instructions: File an Original and 4 Copies of This Charge With the NLRB Regional Director for the Region in Which the Alleged Unfair Labor Practice Occurred or Is Occurring.

Do Not Write in This Space

Case No: 19-CB-97

Date Filed: 2/13/50

Compliance Status Checked by:.....

1. Labor Organization or Its Agents Against Which
Charge Is Brought:

Name: International Association of Heat
and Frost Insulators and Asbestos Workers,
A.F.L., Local No. 7.

Address: 13709-15th Avenue, N. E., Seattle,
Washington.

The Above-Named Organization or Its Agents Has Engaged in and Is Engaging in Unfair Labor Practices Within the Meaning of Section (8b) Subsection 2 of the National Labor Relations Act, and These Unfair Labor Practices Are Unfair Labor Practices Affecting Commerce Within the Meaning of the Act.

2. Basis of the Charge (Be specific as to facts, names, addresses, plants involved, dates, places, etc.):

The above-named labor organization, by its officers, agents and employees, has caused the Charles R. Brower Co. to terminate the employment and/or refuse further employment to the following persons in violation of Section 8 (a)(3) of the Act: Uhro A. Kangas, Alfred J. Vollan, and LeRoy D. Luey,

3. Name of Employer:

Charles R. Brower Co.

4. Location of Plant Involved (Street, City, and State):

114 Virginia St., Seattle, Wn.

5. Nature of Employer's Business:

Insulation contractors.

6. No. of Workers Employed:

Approx. 30.

7. Full Name of Party Filing Charge:

Uhro A. Kangas.

8. Address of Party Filing Charge (Street, City, and State):

3447-38th Avenue, S. W., Seattle 6, Washington.

Tel. No.:

Avalon 8776.

9. Declaration

I Declare That I Have Read the Above Charge and That the Statements Therein Are True to the Best of My Knowledge and Belief.

By /s/ UHRO A. KANGAS,

(Signature of representative
or person making charge)

Representative.

(Title or office, if any)

Date: February 13, 1950.

Wilfully False Statements on This Charge Can Be
Punished by Fine and Imprisonment (U. S.
Code, Title 18, Section 80)

Received February 13, 1950.

[Admitted in evidence September 6, 1950, as General Counsel's Exhibit 1-E.]

United States of America
Before the National Labor Relations Board
Case No. 19-CB-97

In the Matter of:
INT'L ASS'N. OF HEAT & FROST INSULA-
TORS & ASBESTOS WORKERS, LOCAL
No. 7,
and
UHRO A. KANGAS.

AFFIDAVIT OF SERVICE OF CHARGE

Date of Mailing: 2/14/50.

I, the undersigned employee of the National Labor Relations Board, being duly sworn, depose and say that on the date indicated above I served the above-entitled document(s) by post-paid registered mail upon the following persons, addressed to them at the following addresses:

Int'l. Ass'n. of Heat & Frost Insulators &
Asbestos Workers, Local No. 7, 13709-15th Ave-
nue, N. E., Seattle, Washington.

Registered No. 243401.

Return Receipt Requested.

/s/ FLORENCE M. GERGER,
Clerk Typist.

Subscribed and sworn to before me this 14th day
of February, 1950.

/s/ SUSAN A. MIZENKO,
Designated Agent, National
Labor Relations Board.

[Admitted in evidence September 6, 1950, as General Counsel's Exhibit No. 1-F.]

Form NLRB-508.

United States of America
National Labor Relations Board

**CHARGE AGAINST LABOR ORGANIZATION
OR ITS AGENTS**

Important—Read Carefully

Where a Charge Is Filed by a Labor Organization or an Individual or Group Acting on Its Behalf, a Complaint Based Upon Such Charge Will Not Be Issued Unless the Charging Party and any National or International Labor Organization of Which It Is an Affiliate or Constituent Unit Have Complied With Section 9 (f), (g), and (h) of the National Labor Relations Act.

Instructions: File an Original and 4 Copies of This Charge With the NLRB Regional Director for the Region in Which the Alleged Unfair Labor Practice Occurred or Is Occurring.

Do Not Write in This Space

Case No.: 19-CB-97

Additional Charge #1

Date Filed: 2/15/50.

Compliance Status Checked by:.....

1. Labor Organization or Its Agents Against Which Charge Is Brought:

Name: International Association of Heat and Frost Insulators and Asbestos Workers, AFL, Local No. 7.

Address: 13709-15th Avenue, N. E., Seattle, Wash.

The Above-Named Organization(s) or Its Agents Has (Have) Engaged in and Is (Are) Engaging in Unfair Labor Practices Within the Meaning of Section (8b) Subsection(s) (2) of the National Labor Relations Act, and These Unfair Labor Practices Are Unfair Labor Practices Affecting Commerce Within the Meaning of the Act.

2. Basis of the Charge (Be specific as to facts, names, addresses, plants involved, dates, places, etc.):

The above-named labor organization, by its officers, agents and employees, has caused the Charles R. Brower Co. to terminate my employment in violation of Section 8 (a) (3) of the Act.

3. Name of Employer:

Charles R. Brower Co.

4. Location of Plant Involved (Street, City, and State):

114 Virginia St., Seattle, Wash.

5. Nature of Employer's Business:

Insulation Contractors

6. No. of Workers Employed:

Approx. 30

7. Full Name of Party Filing Charge:

Marvin N. Rosand

8. Address of Party Filing Charge (Street, City and State):

3037 Market St., Apt. 106, Seattle 7, Wash.

Tel. No.: HE 2070

9. Declaration

I Declare That I Have Read the Above Charge and That the Statements Therein Are True to the Best of My Knowledge and Belief.

By /s/ MARVIN N. ROSAND,

(Signature of representative or
person making charge)

Individual.

(Title or office, if any)

Date: February 16, 1950.

Wilfully False Statements on This Charge Can Be
Punished by Fine and Imprisonment (U. S.
Code, Title 18, Section 80)

Received February 23, 1950.

[Admitted in evidence September 6, 1950, as General Counsel's Exhibit No. 1-G.]

United States of America Before the National
Labor Relations Board, Nineteenth Region

In the Matter of:

INTERNATIONAL ASSOCIATION OF HEAT
AND FROST INSULATORS AND ASBES-
TOS WORKERS, LOCAL No. 7, AFL,

and

Case No. 19-CB-91

SIDNEY ARTHUR LENNOX (an Individual)

and

Case No. 19-CB-95

TOIVE ELMER ESKOLA (an Individual)

and

Case No. 19-CB-97

MARVIN N. ROSAND (an Individual)

and

SEATTLE CONSTRUCTION COUNCIL (and
Its Members),

Party to the Contract.

CONSOLIDATED COMPLAINT

It having been charged by Sidney Arthur Lennox, an individual, in Case No. 19-CB-91, by Toive Elmer Eskola, an individual, in Case No. 19-CB-95, and by Uhro A. Kangas, Marvin N. Rosand, an individual, in Case No. 19-CB-97, that International Association of Heat and Frost Insulators and As-

bestos Workers, Local No. 7, AFL, with headquarters in Seattle, Washington, has engaged in and is now engaging in certain unfair labor practices affecting commerce as set forth in the Labor Management Relations Act of 1947, 61 Stat. 136, herein called the Act, the General Counsel of the National Labor Relations Board, having previously authorized the consolidation of the three proceedings, on behalf of the National Labor Relations Board, by the Acting Regional Director for the Nineteenth Region, designated by the Board's Rules and Regulations, Series 5, as amended, Section 203.15, hereby issues this Consolidated Complaint and alleges as follows:

I.

E. E. Saberhagen, hereinafter called the Employer, is an individual doing business as Chas. R. Brower & Co., under which name he is engaged at Seattle, Washington, in the distribution and installation of insulating materials in industrial and building construction work and upon sea-going vessels.

II.

During the year 1949, the Employer made purchases of insulating materials having a value of approximately \$200,000, of which in excess of 90% originated at and was shipped to the Employer's Seattle facilities from points outside the State of Washington. During the same period, the Employer had a gross income from sales and services in excess of \$500,000, of which approximately \$70,-

000 represents income from services performed on vessels.

III.

International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, hereinafter called the Respondent, is and, at all times hereinafter mentioned, has been a labor organization within the meaning of Section 2, subsection 5, of the Act.

IV.

Seattle Construction Council, hereinafter called the Construction Council, is an association of employers engaged in the building and construction industry in the Seattle, Washington, area. One purpose for which the Construction Council was organized and exists is to represent its employer members in collective bargaining with labor organizations.

V.

The Employer is, and at all times hereinafter alleged since on or about January 1, 1942, has been, a member of the Construction Council, and at all such times has duly authorized the said Council to represent it in collective bargaining negotiations with the Seattle Building and Construction Trades Council, and to bind it to any agreement entered into with said Building Trades.

VI.

Seattle Building and Construction Trades Council, hereinafter called the Building Trades, is, and

at all times hereinafter mentioned has been, a labor organization within the meaning of Section 2, subsection 5, of the Act, having as members labor organizations with membership among employees of the building and construction industry. One purpose for which the Building Trades was organized and exists is to represent its member organizations in collective bargaining with employers in the building and construction industry.

VII.

The Respondent is, and at all times hereinafter alleged since 1939 has been, a member of the Building Trades, and at all such times, either by virtue of its membership or by specific authorization, has authorized the Building Trades to represent it in collective bargaining negotiations with employer members of the Construction Council, and to bind it to any agreement entered into with said Council.

VIII.

The Respondent has at no time been in compliance with Section 9 (f) (g) and (h) of the Act, nor has any election been conducted by the Board among the asbestos or insulation employees of the members of the Construction Council or of the Employer pursuant to Section 9, subsection (e) (1) of the Act to determine whether said employees desired to authorize the Respondent to make an agreement requiring membership in the Respondent as a condition of employment with member employers

of the Construction Council or with the Employer individually.

IX.

On or about June 30, 1943, the Construction Council entered into an agreement with the Building Trades. Said agreement set forth the wages and working conditions for the building and construction employees of the employer members of the Construction Council.

X.

By virtue of Section 9 of the contract referred to in paragraph IX, above, the members of the Construction Council, including the Employer, were, and are now, bound to employ as asbestos or insulation employees only members of the Respondent.

XI.

The agreement referred to in paragraph IX, above, has been renewed from year to year both before and after the effective date of the Act and is still in effect, and binding upon all members of the Construction Council, including the Employer, and upon all member organizations of the Building Trades, including the Respondent.

XII.

On or about January 24, 1950, the Respondent caused the Employer to refuse to employ Sidney A. Lennox on a ship-conversion job for the reason that he was not a member of the Respondent, although membership had been denied him by the Respondent, because of the Respondent's policy not

to expand its membership and not because of his failure to tender the periodic dues and the initiation fees required by the Respondent.

XIII.

On or about February 8, 1950, the Respondent caused the Employer to lay off Toive E. Eskola, Uhro Kangas, Le Roy Lucy, and Alfred J. Vollan and to refuse to reemploy them on other projects for the reason that they were not members of the Respondent, although membership had been denied them by the Respondent for the same reasons it was denied Sidney A. Lennox, as set forth and described in paragraph XII, above.

XIV.

On or about December 30, 1949, the Respondent caused the Employer to discharge Marvin N. Rosand for the reason that he was not a member of the Respondent, although membership had been denied him by the Respondent for the same reasons it was denied Sidney A. Lennox, as set forth and described in paragraph XII, above.

XV.

The union security provision referred to in paragraph X, above, and any renewal or continuation thereof, is illegal and void because it imposes conditions on employment more restrictive than those permissible under Section 8 (a) (3) of the Act, and because the Respondent has not satisfied a condition precedent of that section, namely, it has not

obtained a Board certification that a majority of the asbestos or insulation employees of the members of the Construction Council, or of the Employer alone, has authorized the Respondent to make a union security agreement.

XVI.

By being a party to the agreement referred to in paragraph IX, above, containing as it does an unlawful union security provision, as noted in paragraph X, above, at a time when such agreement was renewed subsequent to the effective date of the Act, as described in paragraph XI, above; by causing the Employer to refuse to employ Sidney A. Lennox, as set forth and described in paragraph XII above; by causing the Employer to lay off Toive E. Eskola, Uhro Kangas, Le Roy Lucy and Alfred J. Vollan and to refuse to reemploy them, as set forth and described in paragraph XIII, above; and by causing the Employer to discharge Marvin N. Rosand, as set forth and described in paragraph XIV, above; the Respondent has caused employers to discriminate, and is now causing them to discriminate, against their employees in regard to hire or tenure of employment, and to encourage membership in the Respondent in violation of Section 8 (a) (3), and has restrained and coerced employees in the exercise of the rights guaranteed in Section 7 of the Act, and by all of said acts and by each of them, the Respondent has engaged in, and is now engaging in, unfair labor practices within the meaning of Section 8 (b) (1) (A) and 8 (b) (2) of the Act.

XVII.

The activities of the Respondent, as set forth and described in paragraphs XI through XIV, inclusive, occurring in connection with the operations of the Employer (as described in paragraphs I and II, above) and of other employer members of the Construction Council, have a close, intimate, and substantial relation to trade, traffic, and commerce among the several states of the United States and have led and tend to lead to labor disputes burdening and obstructing commerce and the free flow of commerce.

XVIII.

The aforesaid acts of the Respondent, as set forth and described in paragraphs XI through XIV, inclusive, constitute unfair labor practices affecting commerce within the meaning of Section 8 (b) (1) (A) and 8 (b) (2) and Section 2 (6) and (7) of the Act.

Wherefore, the General Counsel of the National Labor Relations Board, on behalf of the Board, on this 22nd day of August, 1950, issues this Consolidated Complaint against International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, the Respondent herein.

/s/ THOMAS P. GRAHAM, JR.,
Regional Director National Labor Relations Board,
Region 19.

[Admitted in evidence September 6, 1950, as General Counsel's Exhibit 1-I.]

[Title of Board and Causes.]

RESPONDENT'S MOTION TO DISMISS;
MOTION TO STRIKE, AND ANSWER

Comes now the International Association of Heat and Frost Insulators and Asbestors Workers, Local No. 7, AFL, and, Moves to Dismiss:

The complaint as not alleging any facts to constitute a violation of law;

Moves to Strike:

- (a) Paragraphs II and VIII as immaterial;
- (b) Paragraphs XV, XVI, XVII, and XVIII as being immaterial and as constituting legal conclusions.

Comes now the International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, and Answers the complaint as follows:

I.

Answering Paragraph I, the respondent has no knowledge or information thereof sufficient to form a belief, and the respondent does therefore deny the same.

II.

Answering Paragraphs II, III, IV, V, VI, VII, VIII, IX, XIII, and XIV, respondent admits the same and the whole thereof.

III.

Answering Paragraph XI, admits the same except the clause, to wit:

“* * * has been renewed from year to year both before and after the effective date of the Act * * *”

which clause is hereby denied.

IV.

The respondent having Moved to Dismiss the complaint as not alleging any facts sufficient to constitute a violation of law; and to Strike

Paragraphs II and VIII as immaterial; and

Paragraphs XV, XVI, XVII and XVIII as being immaterial, and as constituting legal conclusions;

if any of said motions are denied in whole or in part, then the respondent does deny such paragraphs as are not stricken, Except, respondent admits Paragraph II.

Respondent denies Paragraphs X, XII, XIII and XIV and the whole thereof.

Wherefore, respondent having fully Answered the complaint prays that the same be dismissed.

/s/ L. P. GILL,

Attorney for Respondent.

[Admitted in evidence September 7, 1950, as General Counsel's Exhibit No. 1-L.]

United States of America, Before the National
Labor Relations Board, Division of Trial
Examiners, Washington, D. C.

Cases Nos. 19-CB-91, 19-CB-95 and 19-CB-97

In the Matter of:

INTERNATIONAL ASSOCIATION OF HEAT
AND FROST INSULATORS AND ASBES-
TOS WORKERS, LOCAL No. 7, AFL,

and

SIDNEY ARTHUR LENNOX (an Individual),

and

TOIVE ELMER ESKOLA (an Individual),

and

UHRO A. KANGAS and MARVIN N. ROSAND
(Individuals),¹

and

SEATTLE CONSTRUCTION COUNCIL (and Its
Members),

Party to the Contract.

INTERMEDIATE REPORT

Statement of the Case

Upon charges duly filed,² the General Counsel of
the National Labor Relations Board, herein re-

¹This last individual's name was added by amend-
ment to the title of this case over the objection of
the Respondent.

²One of these charges was filed by Marvin N.
Rosand. As Rosand had filed a charge and as his
name had been omitted from the caption of the case,

ferred to as the General Counsel and the Board, respectively, by the Regional Director for the Nineteenth Region (Seattle, Washington), duly issued a consolidated complaint³ dated August 22, 1950, against International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, hereinafter referred to as the Respondent or the Union, alleging that the Respondent had engaged in unfair labor practices within the meaning of Sections 8 (b) (1) (A) and 8 (b) (2) and Section 2 (6) and (7) of the National Labor Relations Act, as amended, 61 Stat. 136, hereinafter called the Act. Copies of this complaint, the charges, and the notice of hearing thereon were duly served upon the Respondent.

With respect to the unfair labor practices, the complaint alleged in substance that the Respondent (1) by being a party to an agreement containing an illegal union-security clause, and (2) by causing E. E. Saberhagen, doing business as Chas. R. Brower & Co., to lay off and to refuse to re-employ six named individuals, has restrained and coerced the employees in the exercise of the rights guaranteed in Section 7 of the Act and is engaging in unfair labor practices within the meaning of Section 8 (b) (1) (A) and 8 (b) (2) of the Act.

although mentioned in the body of the complaint as one of those discriminatorily discharged, the General Counsel moved to amend the caption to correct that omission.

³By appropriate order these cases were all consolidated for hearing.

The Respondent filed its answer admitting certain allegations of the complaint but denying the commission of any unfair labor practices.

Pursuant to notice, a hearing was held in Seattle, Washington, on September 6, 1950, before the undersigned Trial Examiner duly appointed by the Chief Trial Examiner. All parties were represented by counsel, participated in the hearing, and were afforded full opportunity to be heard, to examine and cross-examine witnesses, and to introduce evidence pertinent to the issues involved. At the commencement of the hearing the Respondent moved to dismiss the complaint on the ground that the business of the Company was of essentially a local nature and that, therefore, the Board did not have jurisdiction. This motion was denied. The Respondent's subsequent motion to strike various allegations from the complaint was also denied. All parties waived oral argument at the conclusion of the hearing, but briefs have been received from the General Counsel and the Respondent.

Upon the entire record in the case, and from his observation of the witnesses, the undersigned makes the following

Findings of Fact

I. The Business of the Company

E. E. Saberhagen is an individual doing business as Chas. R. Brower & Co. and is engaged in Seattle, Washington, in the distribution and installation of insulating materials in industrial and building con-

struction and upon seagoing vessels. During its 1949 fiscal year this Company did installation work on vessels belonging to the Army Transport Service, Luckenbach Steamship Company, Northland Transportation Company, and other similar concerns, all of which are engaged in interstate commerce. Most, if not all, of the work done by this Company on seagoing vessels was performed at various shipyards located in and around the State of Washington. It also installed insulation work for various Seattle, Washington, and Portland, Oregon, plumbers and steamfitters in industrial and building construction work. During the year 1949, it purchased goods and materials from outside the State of Washington valued at approximately \$200,000 and received a gross income from its installation work in excess of \$500,000, of which approximately \$60,000 was for materials furnished and services rendered on seagoing vessels, 90 per cent of which moved in interstate commerce. For the year 1950, income received by said Company for this latter type of work was slightly less than it had been for the year 1949.

This Company is a member of, and bound by the labor agreements negotiated by, Seattle Construction Council, a group acting collectively and severally for all of its members who are employers of craftsmen and labor.

The undersigned finds that the Company is engaged in operations affecting commerce among the several States.

II. The Respondent

International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, is a labor organization admitting to membership employees of the Company and is a member of the Seattle, Washington, Building and Construction Council and bound by the labor agreements negotiated for and on its behalf by that body.

III. The Unfair Labor Practices

On June 30, 1943, the Seattle Construction Council acting collectively and severally for all its members, employers of craftsmen and labor, of which Brower & Co. was a member, entered into an agreement with Seattle, Washington, Building and Construction Trades Council acting collectively and severally for all its members, of which the Respondent was one. This agreement contained an escalator wage clause by which wages were to be determined for the period from January 1, 1944, to January 1, 1947.

Paragraph 9 (a) of that agreement provided as follows:

It is further agreed that all members of the Party of the First Part hiring employees will employ none other than members of the Party of the Second Part, as enumerated in Schedule "A" attached hereto, entitled Wage Schedule.

Included in the Schedule "A" mentioned above was the work classification of "asbestos workers," i.e., the group represented by the Respondent here.

The termination clauses of the contract are two-fold: (1) That applicable to the escalator wage clause, which reads as follows:

Paragraph 4 of this contract shall remain in effect until January 1, 1948, unless notice is given 90 days prior to July 1, 1947, and shall renew itself from year to year thereafter. Provided that wages shall be adjusted from time to time as provided for in Paragraph 4.

and (2) that pertaining to the other conditions included in the contract, which read as follows:

All other conditions of this Agreement shall take effect on July 1, 1943, and continue in effect thereafter from year to year until changed by the mutual agreement of the parties as provided herein. Proposed changes or modification of this Agreement shall be made by either party giving notice thereof in writing to the other party at least 90 days before July 1, and such notice shall specify the provisions desired to be changed and shall state the time and place at which negotiations may commence. The other party shall enter into negotiations not later than 30 days from the date of the receipt of said notice, after party has notified the other in writing of proposed modifications and changes in the Agreement. In the event no accord can be reached in the succeeding 60 days, arbitration as provided hereinafter shall be resorted to.

The arbitration therein referred to reads as follows:

It Is Further Agreed by both parties hereto that all disputes and grievances that cannot be speedily and amicably adjusted on the work shall be submitted to the accredited agents of the parties hereto, and if not adjusted by them shall be submitted to the Adjustment Board, whose decision shall be submitted in writing and be final and binding upon both parties. Pending such decision there shall be no strike or lockout, except that where non-union men are employed the Party of the Second Part reserves the right to remove all Union men from the job. In the event the Adjustment Board shall be unable to reach an agreement, the U. S. Department of Conciliation shall be given the opportunity to adjust the difficulty in a manner acceptable to both parties signatory hereto. If such adjustment cannot be reached, both parties and the U. S. Department of Conciliation shall each appoint an umpire and their decision shall be final and binding upon both parties. The umpire appointed by the U. S. Department of Conciliation to be satisfactory to both parties hereto.

Furthermore, it was agreed by all parties that the aforementioned contract remains in full force and effect without modification of any sort to the present date. At the hearing the Respondent suggested that the illegal closed-shop provisions of this con-

tract were not enforced on jobs coming within the jurisdiction of the Board. This contention will be referred to hereinafter.

At all times material herein the Respondent has had, and now has, a membership of approximately 41 persons, who will be referred to herein as "card men." During the war years as many as 350 men were granted permits to work by the Respondent. These men will be hereinafter referred to as "permit men." In addition, the Union permitted "travelers," i.e., card men from other locals of the same International Union, to work in the Seattle area. Since the end of hostilities, as ship construction and repair work has dropped off, the number of permit men has diminished accordingly. This hearing deals with the last of the permit men.

Like much other construction work the insulation jobs, installation or repair, are jobs of short duration, so that the employees work on numerous small jobs lasting but a few days at a time. As these jobs come up, the contractors call the Union for men to do such work and the Union dispatches men as requested. Generally all the asbestos workers are dispatched by the Union upon request from the Employer, although it is also permissible for the men to locate the job and then to secure clearance from the Union before starting work for the contractor involved. The contractors always require clearance from the Union before giving the man employment.

When shipbuilding and ship repair became such an important occupation in the Seattle area during

the war, there was such a shortage of insulation workmen that the Respondent approached other AFL locals in the vicinity seeking volunteers to help carry the work load. From such sources the Respondent recruited Sidney Arthur Lennox, Toive E. Eskola, Uhro A. Kangas, Alfred J. Vollan, LeRoy D. Lucy, and Marvin N. Rosand, all members of other AFL craft unions in the Seattle area, and allowed them to work as asbestos workers under permit from the Respondent. All of these men began their insulation work between the years 1940-43, and all have made their livelihood from it ever since as they only return to their original craft when there is no insulation work to be done, a definite minority of the time. From that time until September, 1949, or February, 1950, as the case might be, each of these men worked under permit from the Respondent, paying the dues required by the Respondent either directly to the Respondent or to the business agent of the local to which each belonged as the arrangement between the Respondent and that other local at the time might require. Up until the date above mentioned these men were dispatched by the business agent of the Respondent in the exact manner as was done with all the other asbestos workers, including the card men. All have paid the required dues at all times and none have worked without clearance from the Respondent.

Three of the men, Lennox, Eskola, and Kangas, made application on one or more occasions between 1947 and 1949 for membership in the Respondent. Each of these applications was rejected by the Re-

spondent. It developed at the hearing that the Respondent had accepted only two new members in the past year and a half or two years. Gagner, business agent of the Respondent, testified that the applications were rejected because the men "were not qualified." It is known, however, that none of these applications was rejected because the applicant lacked the necessary craft skill for membership, as the business agent admitted that none of the applicants had ever been referred to the examining board of the Respondent, which board passes upon the work qualifications of the various applicants. These applicants were blackballed at a general meeting of the membership for the same considerations as are applicable to any fraternal or social organization. None of the other three permit men here involved have applied for membership in the Respondent.⁴

Arthur Lennox performed his last work in the insulation trade in September, 1949. At that time he was laid off at the completion of a job. He heard a rumor that the permit men were not to be allowed to work any more in the industry. Sometime in January, 1950, he spoke to Ben Bradley, superintendent of Chas. R. Brower & Co., about getting a job, and was told by Bradley that there was a job

⁴The business agent candidly testified that "we have built up this trade and must maintain it. * * * It isn't the employer's trade." He also testified that of late years "the pickings" have been "pretty slim" as the work on the waterfront has run approximately one-half a man per day.

for him if he could secure clearance from the Union. When Lennox called Business Agent Gagner, Gagner refused to issue him a permit. Two weeks thereafter Bradley again told Lennox about a certain job he could have if the Union would clear him. At the request of Lennox, Bradley called Gagner and asked that Lennox be assigned to this particular job. Gagner refused Bradley's request. In another telephone conversation at this time Gagner told Lennox that there was no work for permit men as the Respondent was bringing travelers in from Portland and Bellingham. Thus Lennox has been unable to secure employment in the industry where he had earned his livelihood since 1942.

On December 24, 1949, Marvin Rosand was employed on a job for Brower & Co. The business agent of the Respondent telephoned Bradley and said that Rosand was to be replaced by a card man. In accordance with these instructions Bradley laid off Rosand and replaced him thereafter with a card man. Rosand, having heard also that the Respondent was not going to issue permits any longer, has never asked for a job since and has never been assigned by Respondent to any jobs in the industry. He has returned to his former occupation as a pile driver man.

On February 8, 1950, Eskola, Kangas, Vollan, and Lucy were all employed by Brower & Co. on an insulation job that that Company was installing on the USS Freeman, an Army transport ship. When the Company decided to reduce its staff on that job,

Superintendent Bradley telephoned to Business Agent Gagner, informed him of the impending lay-off, and asked him how it should be done. Gagner told him that the permit men should be laid off first. The following day all the permit men were laid off, although some of the card men who remained at work had less seniority on the job. This has been the usual practice in the event of layoff. At the time of this layoff Bradley told some of these men that the business agent of the Respondent had requested that the permit men be laid off.

Since that date no permit men have been assigned work in the insulation field in the Seattle area by the Respondent. In fact, Gagner assured two of the permit men who requested a clearance for various jobs that he would not issue any more permits. He has kept his word.

Conclusions

Obviously the contract involved here is illegal under the terms of the Taft-Hartley Act because the contract provisions create closed-shop conditions whereby employment is conditioned upon union membership and, in addition, because, as admitted in the pleadings, no election as required by Section 9 (e) of the Act has been held authorizing the Union to bargain for any union-security provisions.

The Respondent does not contest this, but argues that the provisions of the Taft-Hartley Act do not make this contract illegal for two reasons: (1) The restrictive provisions of the contract have not been applied to jobs affecting commerce, and (2) because

the Taft-Hartley Act does not apply to this contract which was executed in 1943 and has remained in full force and effect at all times subsequent thereto without change and hence has not been "renewed or extended" since the amendment of the Wagner Act, and thus is legal under the terms of Section 102 of the Act, as amended.

In view of the fact that the terms of this contract have been fully applied and enforced to insulation jobs being performed on ocean-going vessels as exemplified in the cases of each of the six individuals here involved, the Respondent's original contention is not only inaccurate but, also, without merit.

The Respondent's second contention, however, depends upon the interpretation to be made of Section 102 of the Act, which reads as follows:

No provision of this title shall be deemed to make an unfair labor practice any act which was performed prior to the date of the enactment of this Act which did not constitute an unfair labor practice prior thereto, and the provisions of Section 8 (a) (3) and Section 8 (b) (2) of the National Labor Relations Act as amended by this title shall not make an unfair labor practice the performance of any obligation under a collective bargaining agreement entered into prior to the date of the enactment of this Act, or (in the case of an agreement for a period of not more than one year) entered into on or after such date of enactment, but prior to the effective date of this title, if the performance of such obligation

would not have constituted an unfair labor practice under Section 8 (3) of the National Labor Relations Act prior to the effective date of this title, unless such agreement was renewed or extended subsequent thereto.

In view of the phraseology used in the contract in the instant proceeding:

All other conditions of this Agreement shall take effect on July 1, 1943, and continue in effect thereafter from year to year until changed by mutual agreement of the parties as provided herein, * * *

together with the customary 90-day notice of proposed changes, and in view of the phraseology used in the contract regarding the wage provisions thereof:

Paragraph 4 of this contract shall remain in effect until January 1, 1948, unless notice is given 90 days prior to July 1, 1947, and shall renew itself from year to year thereafter, * * *

it would appear that this contract from at least on and after July 1, 1948, became a contract of 1-year duration, automatically renewing itself with the consent of the parties upon their failure to file a request for changes in accordance with the provisions thereof. Thus on its face the contract here was renewed or extended as of July 1, 1948, and has been renewed or extended subsequent thereto.⁵

⁵Clara-Val Packing Company, 87 NLRB No. 120; Salant & Salant, Inc., 88 NLRB No. 156, and Acme-Evans Company, Inc., 90 NLRB No. 293.

The action of the parties in remaining inactive at the 90-day period constituted their mutual agreement to "extend or renew" the contract for another year.

However, the Respondent argues that the cases cited for the proposition above are inapplicable here for the reason that this contract provides for arbitration in the event that the parties to the contract should be unable to agree upon the requested changes in conditions of employment after 60 days of negotiations, that this arbitration decision is final and binding on both parties and, therefore, the contract here is made perpetual by reasons of its arbitration features, while in the cases above cited there were no similar arbitration features and thus automatically ceased to exist at the end of the anniversary period in the event of an unsettled state of negotiations. Unfortunately for the Respondent's contention here there is no such arbitration feature connected with the escalator wage scale provisions of the present contract, although changes could be demanded therein by notice given 90 days prior to the date of July 1. Thus, an essential feature of this contract would expire in the event of an unsettled dispute over changes therein.

The undersigned, therefore, concludes and finds that on and after July 1, 1947, the contract at issue here became a contract of 1-year duration, automatically renewable on its anniversary date under certain conditions and, thus, this contract has also been "renewed or extended" subsequent to the passage of the Taft-Hartley bill.

There remains but one other contention made by the Respondent, which is that the Union did not insist or cause the layoff or refusal to employ the individuals here involved, and that the Company itself was solely responsible for those acts. This contention is based upon a conflict of testimony created by Gagner's denial that he required or caused the Company to discharge the men involved here. This conflict the undersigned has been forced to resolve in accordance with the testimony of the superintendent of Brower & Co., corroborated by the testimony of the six individuals as against the testimony of Gagner and his fellow business agent, Kinsman. The subsequent facts disprove the testimony of the two officials of the Respondent Union. The men have not been re-employed solely because the Respondent refused to clear the men to the Employer, who was not free under the terms of the agreement to employ such non-members without such Union clearance.

The Respondent's business agents also contended that, when the six individuals called them for jobs, there were no jobs available to which they could have been assigned. This testimony does not jibe with the testimony of Superintendent Bradley, who testified that his Company practically at all times has had an order for men with the Union and that a good part of the time the Union was unable to furnish the requested employees. In view of the increase in ship construction and repair, the undersigned accepts the testimony of Superintendent Bradley.

The undersigned, therefore, concludes and finds that the Respondent by its officials caused the Company to discriminate in regard to the hire and/or tenure of employment of Sidney A. Lennox, Toive E. Eskola, Uhro A. Kangas, Alfred Vollan, LeRoy Lucy, and Marvin N. Rosand, in order to encourage membership in the Respondent and because membership in that organization had been denied to the above-named individuals for reasons other than the failure to tender the periodic dues and initiation fees or because of the fact that said individuals were not members of the Respondent Union.

IV. The Effect of the Unfair Labor Practices Upon Commerce

The activities of the Respondent set forth in Section III, above, occurring in connection with the operations of the Company described in Section I, above, have a close, intimate, and substantial relation to trade, traffic, and commerce among the several States, and tend to bring about labor disputes burdening and obstructing commerce and the free flow of commerce.

V. The Remedy

Having found that the Respondent has engaged in and is now engaging in unfair labor practices, it will be recommended that it cease and desist therefrom and take certain affirmative action designed to effectuate the policies of the Act.

It has been found that the Respondent by requiring the enforcement of a contract containing an

illegal union-security provision, by refusing to issue work permits to non-members of the Union, and by causing the Employer to discriminate in regard to the hire and tenure of employment of persons who were not members of the Union or who had been refused Union membership for reasons other than the failure to tender the periodic dues and initiation fees, has committed unfair labor practices, and is now committing unfair labor practices in violation of Section 8 (b) (2). The undersigned will, therefore, recommend that the Respondent cease and desist from such practices and notify Seattle Construction Council (and its members) and Chas. R. Brower & Co., in writing that it no longer considers the union-security clause of its agreement with them to be in effect or binding upon the parties. As the other provisions of said contract have apparently been satisfactory for many years to all parties concerned, including the individuals here involved, the undersigned believes that it would lead to instability in otherwise harmonious labor relations to require that the whole contract be set aside and, therefore, will limit this requirement to the elimination of the illegal clauses therein.

By the same aforementioned act, the Respondent has also restrained and coerced employees in the exercise of the rights guaranteed to them in Section 7 of the Act in violation of Section 8 (b) (1) (A) of the Act. The undersigned will also order the Respondent to cease and desist therefrom. See *Clara-Val Packing Company*, 87 NLRB No. 120.

As the Respondent has, by the aforementioned

acts, deprived the above-named individuals from gainful employment, the undersigned will order the Respondent to make each of the individuals whole for any loss of pay which each may have suffered by reason of the Respondent's unfair labor practices from the date of the discrimination against him to the date of the compliance of the Respondent with this recommendation. This loss of pay shall be computed in the manner set forth in *F. W. Woolworth Company*, 90 NLRB No. 41.

Upon the basis of the above findings of fact and upon the entire record in this case, the undersigned makes the following

Conclusions of Law

1. International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, is a labor organization within the meaning of Section 2 (5) of the Act.

2. By requiring the enforcement of a contract containing illegal union-security provisions, by refusing to issue work permits to non-members of the Union, and by causing the employers to discriminate in regard to the hire and tenure of employment of persons who were not members of the Union or who had been refused membership in said Union for reasons other than their failure to tender the periodic dues and initiation fees, the Respondent violated Section 8 (b) (2) of the Act.

3. By the aforementioned acts the Respondent restrained and coerced employees in the exercise

of the rights guaranteed in Section 7 of the Act, thereby violating Section 8 (b) (1) (A) of the Act.

4. The aforementioned unfair labor practices are unfair labor practices affecting commerce within the meaning of Section 2 (6) and (7) of the Act.

Recommendations

Upon the basis of the foregoing findings of fact and conclusions of law, and upon the entire record in this case, the undersigned recommends that: the Respondent Union, International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, its officers, representatives, agents, successors, and assigns, shall:

1. Cease and desist from:

(a) Requiring the enforcement of the contract containing illegal union-security provisions, refusing to issue work permits to non-members of the Union, and causing Seattle Construction Council (and its members) and Chas. R. Brower & Co., to discriminate in regard to the hire and tenure of employment of persons who are not members of the Union or who have been refused membership in said Union for reasons other than their failure to tender the periodic dues and initiation fees in violation of Section 8 (b) (2) of the Act;

(b) Restraining or coercing employees or prospective employees in the exercise of their right to refrain from any and all concerted activities listed in Section 7 of the Act except to the extent that

such rights may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized by Section 8 (a) (3) of the Act.

2. Take the following affirmative action which the undersigned finds will effectuate the policies of the Act:

(a) Notify Seattle Construction Council (and its members) and Chas. R. Brower & Co., that it no longer considers the union-security provisions of the contract between it and said Council and Brower & Co. to be in effect or binding upon the parties;

(b) Notify Seattle Construction Council (and its members) and Chas. R. Brower & Co., in writing, and furnish copies of said notice to the individuals involved, that it withdraws its objections to the employment of Sidney A. Lennox, Toive E. Eskola, Uhro A. Kangas, Alfred Vollan, LeRoy Lucy, and Marvin N. Rosand, and that it has no objections to the employment of said individuals;

(c) Make whole the said Sidney A. Lennox, Toive E. Eskola, Uhro A. Kangas, Alfred Vollan, LeRoy Lucy, and Marvin N. Rosand for any loss of pay he may have suffered by reason of the Respondent's discrimination against him, in the manner provided herein in the section entitled "The Remedy";

(d) Post immediately in its business office and wherever notices to its members are customarily posted, copies of the notice attached hereto marked Appendix A. Copies of said notice, to be furnished by the Regional Director for the Nineteenth Region,

shall, after being duly signed by an official representative of the Respondent Union, be posted by it immediately upon receipt thereof and be maintained for a period of at least sixty (60) consecutive days thereafter in conspicuous places, including all places where notices to members are customarily posted. Reasonable steps shall be taken by the Respondent Union to insure that said notices are not altered, defaced, or covered by any other material;

(e) Notify the Regional Director for the Nineteenth Region in writing within twenty (20) days from the date of the receipt of this Intermediate Report what steps it has taken to comply herewith.

As provided in Section 203.46 of the Rules and Regulations of the National Labor Relations Board any party may, within twenty (20) days from the date of service of the order transferring the case to the Board, pursuant to Section 203.45 of said Rules and Regulations, file with the Board, Washington 25, D. C., an original and six copies of a statement in writing setting forth such exceptions to the Intermediate Report or to any other part of the record or proceeding (including rulings upon all motions or objections) as he relies upon, together with the original and six copies of a brief in support thereof; and any party may, within the same period, file an original and six copies of a brief in support of the Intermediate Report. Immediately upon the filing of such statement of exceptions and/or briefs, the party filing the same shall serve a copy thereof upon each of the other parties. State-

ments of exceptions and briefs shall designate by precise citation the portions of the record relied upon and shall be legibly printed or mimeographed, and if mimeographed shall be double spaced. Proof of service on the other parties of all papers filed with the Board shall be promptly made as required by Section 203.85. As further provided in said Section 203.46 should any party desire permission to argue orally before the Board, request therefor must be made in writing to the Board within ten (10) days from the date of service of the order transferring the case to the Board.

In the event no Statement of Exceptions is filed as provided by the aforesaid Rules and Regulations, the findings, conclusions, recommendations, and recommended order herein contained shall, as provided in Section 203.48 of said Rules and Regulations, be adopted by the Board and become its findings, conclusions, and order, and all objections thereto shall be deemed waived for all purposes.

Signed at Washington, D. C., this 18th day of October, 1950.

/s/ THOMAS S. WILSON,
Trial Examiner.

Appendix A

Notice

To All Members of International Brotherhood of
Heat and Frost Insulators and Asbestos Work-
ers Union, Local No. 7, AFL,

Pursuant to

The Recommendations of a Trial Examiner
of the National Labor Relations Board, and in order
to effectuate the policies of the National Labor Re-
lations Act, we hereby notify you that:

We Have notified Seattle Construction Council
(and its members) and Chas. R. Brower & Co., that
the union-security provisions contained in our con-
tract with them is no longer binding and of any
effect and that they are free to employ the following
individuals:

Sidney A. Lennox

Toive E. Eskola

Uhro A. Kangas

Alfred Vollan

LeRoy Lucy

Marvin N. Rosand

and that this Union will grant work permits to said
individuals.

We Will make whole the above-named individuals
for any loss of pay suffered because of the discrimi-
nation against each of them.

We Will Not restrain or coerce employees or
prospective employees of Seattle Construction
Council (and its members) and Chas. R. Brower

& Co., or any other employer in the exercise of their right to refrain from engaging in concerted activities as guaranteed them by Section 7 of the Act except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in Section 8 (a) (3) of the Act.

We Will Not in any manner cause or attempt to cause Seattle Construction Council (and its members) and Chas. R. Brower & Co., or any other employers to discriminate against any employee or prospective employee in violation of Section 8 (a) (3) of the Act.

INTERNATIONAL BROTHERHOOD OF HEAT
AND FROST INSULATORS AND ASBESTOS
WORKERS UNION, LOCAL No. 7,
AFL,

(Union)

By,

(Representative) (Title)

Dated

This notice must remain posted for 60 days from the date of posting, and must not be altered, defaced, or covered by any other material.

United States of America, Before the
National Labor Relations Board

Cases Nos. 19-CB-91, 19-CB-95 and 19-CB-97

In the Matter of:

INTERNATIONAL ASSOCIATION OF HEAT
AND FROST INSULATORS AND ASBES-
TOS WORKERS, LOCAL No. 7, AFL,

and

SIDNEY ARTHUR LENNOX (an Individual),

and

TOIVE ELMER ESKOLA (an Individual),

and

UHRO A. KANGAS and MARVIN N. ROSAND
(Individuals),

and

SEATTLE CONSTRUCTION COUNCIL (and Its
Members),

Party to the Contract.

DECISION AND ORDER

On October 18, 1950, Trial Examiner Thomas S. Wilson issued his Intermediate Report in the above-entitled proceeding, finding that the Respondent had engaged in and was engaging in certain unfair labor practices and recommending that it cease and desist therefrom and take certain affirmative action, as set forth in the copy of the Intermediate Report attached hereto. Thereafter, the Respondent filed

exceptions to the Intermediate Report and a supporting brief. The Respondent also requested oral argument. That request is hereby denied, as the record, including the brief and exceptions, in our opinion, adequately presents the issues and the positions of the parties.

The Board¹ has reviewed the rulings made by the Trial Examiner at the hearing and finds that no prejudicial error was committed. The rulings are hereby affirmed. The Board has considered the Intermediate Report, the exceptions and brief, and the entire record in the case, and hereby adopts the findings, conclusions, and recommendations of the Trial Examiner, with the following modifications:

1. The Trial Examiner found, and we agree, that the Respondent, a labor organization, refused to issue work permits to the six individuals named in the complaint and, pursuant to illegal union-security provisions in a contract, dated June 30, 1943, required Chas. R. Brower & Co., an employer, to lay off or refuse to hire, as the case may be, the six individuals because they did not have such work permits, in violation of Section 8 (b) (2) and 8 (b) (1) (A) of the Act. The Respondent contended that the contract, entered into before the effective date of the 1947 amendments, was not renewed thereafter and that the validity of the contract was thus preserved by Section 102 of the Act. In making

¹Pursuant to the provisions of Section 3 (b) of the Act, the Board has delegated its powers in connection with this case to a three-member panel.

this contention, the Respondent urges that certain so-called arbitration provisions of the contract make it one of perpetual duration and thus this case is distinguishable from others in which the Board has held that a contract was renewed within the meaning of Section 102. In rejecting this contention, the Trial Examiner construed the contract so as to make the so-called arbitration provisions inapplicable to Paragraph 4 of the contract which provides that its wage provisions "shall remain in effect until January 1, 1948, unless notice is given 90 days prior to July 1, 1947, and shall renew itself from year to year thereafter * * *." We do not so construe the contract. However, we agree with the Trial Examiner that the contract was renewed after the effective date of the amended Act, and before the unfair labor practices of the Respondent occurred, within the meaning of Section 102. We have held in the cases cited by the Trial Examiner that a renewal of a contract resulted from the operation of an automatic renewal clause, contained in the contract, which provided that unless notice was given by one of the parties within a prescribed time, the contract was to bind the parties for an additional stated period. The contract in the instant case, in addition to the provisions quoted above, further provides that "* * * All other provisions of this Agreement shall take effect on July 1, 1943, and continue in effect thereafter from year to year until changed by the mutual agreement of the parties as provided herein * * *." The contract also provides in substance that notice of proposed changes may be given

by either party not less than 90 days before any July 1 and, if negotiations as to the proposals fail, resort be had to arbitration, which shall be final and binding (the so-called arbitration provisions). For present purposes, we perceive no vital distinction between a contract containing such clauses and those found in the cases cited by the Trial Examiner.

2. The Trial Examiner recommended that the Respondent be required to make each of the six individuals whole for any loss of pay which each may have suffered by reason of the Respondent's unfair labor practices from the date of the discrimination against each of the discriminatees to the date of the Respondent's compliance with "this recommendation." In accordance with our usual practice in similar cases,² we shall require the Respondent (1) to pay to each of the six discriminatees a sum of money equal to the amount that he normally would have earned as wages during the period from the date of discrimination against him to 5 days after the date on which the Respondent notifies, in writing, the Employer, Chas. R. Brower & Co., that the Respondent no longer has objection to his immediate employment, less his net earnings during such period, as computed on the basis of each separate calendar quarter or portion

²See, for example, Pinkerton's National Detective Agency, Inc., 90 NLRB No. 39; Pen and Pencil Workers Union, Local 19593, AFL (Wilhelmina Becker), 91 NLRB No. 155.

thereof during this period, and less such other sums as the Employer, absent the discrimination, would normally have deducted from his wages for deposit with State and Federal agencies on account of social security and other similar benefits; and (2) to pay to the appropriate State and Federal agencies, to the credit of the six discriminatees and the Employer, a sum of money equal to the amount which, absent the discrimination, would have been deposited to such credit by the Employer, either as a tax upon the Employer or on account of deductions made from the six discriminatees' wages by the Employer, on account of such social security and other similar benefits.

Order

Upon the entire record in the case, and pursuant to Section 10 (c) of the National Labor Relations Act, as amended, the National Labor Relations Board hereby orders that the Respondent, International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, its officers, representatives, agents, successors, and assigns, shall

1. Cease and desist from:

(a) Requiring the enforcement of its existing contract with Seattle Construction Council containing illegal union-security provisions and causing Seattle Construction Council and its members, including Chas. R. Brower & Co., to discriminate in regard to the hire and tenure of employment of

persons who are not members of the Union or who have been refused membership in said Union for reasons other than their failure to tender the periodic dues and initiation fees, in violation of Section 8 (b) (2) of the Act;

(b) Restraining or coercing employees or prospective employees in the exercise of their right to refrain from any and all concerted activities listed in Section 7 of the Act, except to the extent that such rights may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized by Section 8 (a) (3) of the Act.

2. Take the following affirmative action which the Board finds will effectuate the policies of the Act:

(a) Notify Seattle Construction Council and its members, including Chas. R. Brower & Co., that it no longer considers the union-security provisions of the contract between it and said Council to be in effect or binding upon the parties;

(b) Notify Seattle Construction Council and its members, including Chas. R. Brower & Co., in writing, and furnish copies of said notice to the individuals involved, that it withdraws its objections to the employment of Sidney A. Lennox, Toive E. Eskola, Uhro A. Kangas, Alfred Vollan, LeRoy Lucy, and Marvin N. Rosand, and that it has no objection to the employment of said individuals;

(c) Make whole the said Sidney A. Lennox, Toive E. Eskola, Uhro A. Kangas, Alfred Vollan,

LeRoy Lucy, and Marvin N. Rosand for any loss of pay that each may have suffered by reason of the Respondent's discrimination against him, in the manner provided herein and in the section of the Intermediate Report entitled "The Remedy";

(d) Post immediately in its business office and wherever notices to its members are customarily posted, copies of the notice attached hereto marked Appendix A.³ Copies of said notice, to be furnished by the Regional Director for the Nineteenth Region, shall, after being duly signed by an official representative of the Respondent Union, be posted by it immediately upon receipt thereof and be maintained for a period of at least sixty (60) consecutive days thereafter in conspicuous places, including all places where notices to members are customarily posted. Reasonable steps shall be taken by the Respondent Union to insure that said notices are not altered, defaced, or covered by any other material;

(e) Notify the Regional Director for the Nineteenth Region in writing, within ten (10) days from the date of this Order, what steps it has taken to comply herewith.

³In the event that this Order is enforced by decree of a United States Court of Appeals, there shall be inserted before the words "A Decision and Order" on this notice the words "A Decree of the United States Court of Appeals Enforcing."

Signed at Washington, D. C., this 15th day of December, 1950.

JOHN M. HOUSTON,
Member;

JAMES J. REYNOLDS, JR.,
Member;

PAUL L. STYLES,
Member;

[Seal]

NATIONAL LABOR
RELATIONS BOARD.

Appendix A

Notice

To All Members of International Brotherhood of Heat and Frost Insulators and Asbestos Workers Union, Local No. 7, AFL:

Pursuant to

A Decision and Order

of the National Labor Relations Board, and in order to effectuate the policies of the National Labor Relations Act, we hereby notify you that:

We Have notified Seattle Construction Council and its members, including Chas. R. Brower & Co., that the union-security provisions contained in our contract with them are no longer binding and of any effect and that they are free to employ the following individuals:

Sidney A. Lennox

Toive E. Eskola

Uhro A. Kangas

Alfred Vollan

LeRoy Lucy

Marvin N. Rosand

We Will make whole the above-named individuals for any loss of pay suffered because of the discrimination against each of them.

We Will Not restrain or coerce employees or prospective employees of employer members of Seattle Construction Council, including Chas. R. Brower & Co., or any other employer, in the exercise of their right to refrain from engaging in concerted activities as guaranteed them by Section 7 of the Act, except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment, as authorized in Section 8 (a) (3) of the Act.

We Will Not in any manner cause or attempt to cause Seattle Construction Council and its members, including Chas. R. Brower & Co., or any other employer, to discriminate against any employee or prospective employee in violation of the Act.

INTERNATIONAL BROTHERHOOD OF HEAT
AND FROST INSULATORS AND ASBESTOS
WORKERS UNION, LOCAL No. 7,
AFL,

(Union)

By

(Representative) (Title)

Dated

This notice must remain posted for 60 days from the date of posting, and must not be altered, defaced, or covered by any other material.

[Title of Board and Cause.]

PETITION FOR RECONSIDERATION AND
PETITION TO RE-OPEN RECORD

Comes Now the International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, Respondent, and respectfully moves the National Labor Relations Board to

Reconsider its "Decision and Order" issued herein on December 15, 1950; and to

Direct the re-opening of the record herein for the purpose of receiving additional testimony from the Respondent of facts transpiring subsequent to October 18, 1950, to wit:

the Respondent abandoned the so-called "permit system"; did notify all of their employers thereof, and all of the employers have since said time hired their employees without any requirement that they join, belong to or secure "permits from the Respondent"; that the Seattle Construction Council and the Chas. R. Brower & Co. knew of said facts during all of said times; that during all of said times there was no requirement that

Sidney A. Lennox

Toive E. Eskola

Uhro A. Kangas

Alfred Vollan

LeRoy Lucy

Marvin N. Rosand

be a member or, join or secure a "permit" from the Respondent in order to be employed by the Chas. R. Brower & Co. or any other employer as an insulation employee or at any other type of work;

and other testimony relating to the same subject; with a right of cross-examination to the General Counsel.

In making this statement, the Respondent does not state that there had been any restrictions prior to said time; but states that these additional facts are further proof of the position of the Respondent that it has at no time maintained a "permit" requirement against said persons. Respondent understands that the Board has ruled unfavorably on this subject, but Respondent Asserts that the additional facts renders moot several of items of affirmative action that the Board requires and makes necessary an amendment to the rule for computing the loss of pay. The requirement for giving of Notice and Posting is made useless, and the requirement for compensating for loss of pay presumes the use of a date subsequent to December 18, 1950, (the date when the Decision and Order was re-

ceived) while the additional Facts require the use of a retroactive date.

Respondent refers to its Objections to the Intermediate Report and incorporates the same herein. Respondent requests that the Board reconsider its Decision and Order on the basis of these Objections and dismiss the Complaint.

Copies of this document will be simultaneously served on all parties.

Dated this 22nd day of December, 1950.

/s/ L. PRESLEY GILL,
Attorney for Respondent.

Received December 26, 1950.

[Title of Board and Cause.]

ORDER DENYING PETITION AND MOTION

On December 15, 1950, the Board issued a Decision and Order in the above-entitled proceeding on December 26, 1950, counsel for the Respondent filed a "Petition for Reconsideration and Petition to Re-open Record"; and thereafter on January 2, 1951, counsel for the General Counsel filed a "Motion for Reconsideration of Board Remedy and Order and Reply to Respondent's Petition for Reconsideration and Petition to Re-open Record," and the Board having duly considered the matter,

It Is Hereby Ordered that the "Petition for Reconsideration and Petition to Re-open Record"

be, and it hereby is, denied for the reason that the aforesaid Petition presents no material issue not previously considered and for the reason that the testimony sought to be adduced is not material or relevant to the issues in the case; and

It Is Further Ordered that the Motion for Reconsideration of the Board's Remedy and Order be, and it hereby is, denied for the reason that it would not effectuate the policies of the Act to modify the Board's Order as requested.

Dated, Washington, D. C., January 17, 1951.

By decision of the Board:

/s/ FRANK M. KLEILER,
Executive Secretary.

Before the National Labor Relations Board
Nineteenth Region

Cases Nos. 19-CB-91, 19-CB-95, and 19-CB-97

In the Matter of:

INTERNATIONAL ASSOCIATION OF HEAT
AND FROST INSULATORS AND ASBES-
TOS WORKERS, LOCAL No. 7, AFL,

and

SIDNEY ARTHUR LENNOX (An Individual)

and

TOIVE ELMER ESKOLA (An Individual),

and

MARVIN N. ROSAND (An Individual),

and

SEATTLE CONSTRUCTION COUNCIL (and
Its Members),

Party to the Contract.

PROCEEDINGS

Wednesday, September 6, 1950

Pursuant to notice, the above-entitled matter
came on for hearing at 10:00 o'clock a.m.

Before: Thomas S. Wilson, Esq.,
Trial Examiner.

Appearances:

ROBERT E. TILLMAN, ESQ.,

Appearing on Behalf of the
National Labor Relations Board.

L. PRESLEY GILL, ESQ.,

Appearing on Behalf of the International
Association of Heat and Frost Insulators
and Asbestos Workers, Local No. 7,
AFL, the Respondent.

OLIVER GAGNER, Secretary,

Appearing on Behalf of International As-
sociation of Heat and Frost Insulators
and Asbestos Workers, Local No. 7,
AFL., the Respondent. [2*]

* * *

Mr. Tillman: In connection with the original Charge in 19-CB-97, which I mentioned was inadvertently not attached to the Complaint, it was also not—I might say the Complaint also was not in conformity with the original Charge insofar as the caption fails to set forth the name of the charging party. Therefore, I would move to amend the caption of the case, on the line where appears the name, Marvin N. Rosand, by adding before that name the words, "Uhro A. Kangas," and making it read then on that line, "Uhro A. Kangas and Marvin N. Rosand."

Then, I also move to substitute for the words on

* Page numbering appearing at foot of page of original Reporter's Transcript of Record.

that same line, "an individual" the word "individuals." [8]

* * *

Mr. Tillman: Then in the opening paragraph, line 3, I would move to make the same changes as I made in the caption by inserting before the name, Marvin N. Rosand, the name Uhro A. Kangas; then, changing the words "an individual" to read "individuals." Those are all the motions. [9]

* * *

Trial Examiner Wilson: Let me get this straight, Mr. Tillman. Under this Complaint who is the General Counsel considering to be the so-called eight individuals, besides these three?

Mr. Tillman: Six individuals—Sidney A. Lennox as set forth in paragraph 12; Toive E. Eskola, Uhro A. Kangas, LeRoy Lucy and Alfred J. Vollan in paragraph 13, and in paragraph 14, Marvin N. Rosand.

Trial Examiner Wilson: They are all mentioned in the [10] Complaint?

Mr. Tillman: That is right.

* * *

Trial Examiner Wilson: And you contend you are surprised, Mr. Gill?

Mr. Gill: Surprised on this basis. We have a Motion to Strike the three, and it is basically sound, legally, that any proof of discrimination against Kangas would not be proof of discrimination on the issues of the case as to Vollan and Rosand, and the Charge I have here next to our copy, the service

copy for Rosand, doesn't mention Kangas in any way in the Charge. We have had no notice of the Charge as to proceeding to a hearing on Kangas except just a moment ago.

Trial Examiner Wilson: You mean to tell me you are not prepared to go ahead and defend the case against Kangas?

Mr. Gill: If you will grant a recess—if that is the basis of your line of thinking—I will inquire of my people. If it is possible that I can have a short recess and make inquiry. I want to be fair about it on that issue.

Trial Examiner Wilson: Well, Mr. Gill, as the names are all mentioned here in various and sundry paragraphs, including Paragraph 16, I am not quite prepared to see how you have been taken by surprise. I will deny this motion, Mr. Gill. Do you want to be heard on your motion to strike and your motion to dismiss? [11]

* * *

ELLIOTT DeFOREST

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Tillman:

* * *

Q. And, Mr. DeForest, what is your occupation?

A. I am Assistant Manager of Charles R. Brower & Co. [18]

* * *

(Testimony of Elliott DeForest.)

Q. Who is the owner?

A. Saberhagen—S-a-b-e-r-h-a-g-e-n.

Q. Where is the location of the company?

A. 114 Virginia Street, Seattle.

Q. And the nature of the business?

A. Insulation contractors.

Q. As insulation contractors what sort of work does the company do?

A. It performs contracts on new construction and on vessels in shipyards.

* * *

Q. Over the years has there been any valuation placed upon the manufacturing part of the company?

A. I don't know whether I could segregate it now.

Q. What sort of buildings does the company put insulation work in?

A. Well, buildings of all types—public buildings, hospitals, schools, apartments.

Q. And what type of vessels?

A. Any type of vessels that are repaired in these waters. The work is generally done in the shipyards. [19]

Q. Well, could you be more explicit and indicate what types of vessels use insulation or at least what types you put insulation in?

* * *

A. Well, vessels of the Military Transport Service, for instance; Luckenback Steamship Company,

(Testimony of Elliott DeForest.)

the Northland Transportation Company here under discussion.

Trial Examiner Wilson: The Northland Steamship Company running between Seattle and Alaska?

The Witness: Seattle and Alaska.

Q. * * * What proportion of the vessels that you work on from a monetary standpoint are vessels that are engaged in going overseas from one point in the State of Washington to a point elsewhere?

A. Oh, I would estimate that perhaps 90 per cent of them are off-shore vessels, because the small vessels require a very small amount of this type of insulation.

Q. Has the amount of work done on vessels changed any since the year 1949 down to the present time?

A. Well, I believe the amount of work on vessels in 1950 has been less than in 1949. [20]

* * *

Q. (By Mr. Tillman): I will ask you to merely indicate the [21] shipyards from whom the company received its income during the fiscal year. If you like you can merely total it up and give us the total.

A. I find here a total of \$60,000 for the shipyards.

Q. All right. In the Complaint we have alleged the year 1949 as showing that the company had a gross income in excess of \$500,000. How does that

(Testimony of Elliott DeForest.)

figure compare with your gross income for your last fiscal year? Was it in excess of \$500,000?

A. The income for the last fiscal year was in excess of \$500,000.

* * *

Mr. Tillman: I think that is all the questions.

Trial Examiner Wilson: Before Mr. Gill starts, could you give us an estimate of the amount of work done on vessels for the year 1950? [22]

* * *

The Witness: This present fiscal year—\$60,000.

Trial Examiner Wilson: \$60,000. Thank you. And you estimate that 90 per cent of that is done on seagoing vessels?

The Witness: On seagoing vessels.

Trial Examiner Wilson: All right. Mr. Gill?

Cross-Examination

By Mr. Gill:

Q. Within the last fiscal year, which ended August 31, 1950, was any work done on vessels owned by the Army Transport Service?

* * *

A. Well, I'd say perhaps 10 per cent of this \$60,000.

Q. And for vessels owned or operated by the Luckenback Steamship Company?

A. I don't believe I can give you any exact figure, Mr. Gill. [23]

* * *

Q. So within the last fiscal year your work on

interstate vessels has been approximately \$60,000?

A. No, sir, I don't say that, because most of these vessels in the shipyards we don't know the owner or the agent. We know that they are a large type of vessel engaged in off-shore and intercoastal trade, but except for a few special instances, I don't know the owner.

* * *

ELTON HICKOK

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows:

Direct Examination

* * *

Q. (By Mr. Tillman): And what is your occupation, Mr. Hickok?

A. I am Manager of the Seattle Chapter of Associated General Contractors and the Seattle Construction Council.

* * *

Q. As manager, is it one of your functions to participate in negotiations with labor unions?

A. Yes, sir. [25]

* * *

(The document heretofore marked General Counsel's Exhibit No. 2 for identification, was received in evidence.)

(Testimony of Elton Hickok.)

GENERAL COUNSEL'S EXHIBIT No. 2

Agreement

1. This Agreement, made in duplicate this 30th day of June, 1943, by Seattle Construction Council, acting collectively and severally for all of its members, employers of craftsmen and labor, Party of the First Part, and Seattle, Washington, Building and Construction Trades Council, Party of the Second Part, acting collectively and severally for all their members.

* * *

4. To determine the wage scales for the Building Trades from January 1, 1944, and each calendar year thereafter to and including January 1, 1947, it is hereby agreed that we follow the following plan:

We shall take the U. S. Department of Labor's National Index on the cost of living, based on 198 items including commodities, services and rents of the average workmen in the United States, as the basis index for our purpose. If from the reports of March 15, 1944, there is an increase of 5 points or more, or any equivalent thereafter, there shall be an increase in the respective wages in our Building Trades contract. This increase shall be based upon an average wage of \$1.30 and we will take the per cent increase in the cost of living which the 5-point fluctuation equals, and that percentage of \$1.30 shall be the increase for each trade in the Building Trades. Should there be a decrease of

(Testimony of Elton Hickok.)

General Counsel's Exhibit No. 2—(Continued)

5 points in the cost of living, or its equivalent, from the preceding March 15 reports there shall be revisions downward, figured on the same basis as are the increases, with the exception that should the scales get down to those existing as of January 1, 1940, then the decrease shall cease to be automatic and Paragraph 4 of this contract shall be thrown open for revision.

It is hereby further agreed that increases or decreases which may be determined, such increases or decreases become effective as of January 1st of the following year. There shall be no work given protection after date specified.

It now appears that since the index of March 15, 1942, which was 114.3, the Department of Labor's Cost of Living indexes as of April 15, 1943, increased to 124.11, an increase of 10.8. It is further recognized that cost of living indexes have not apparently decreased since April 15, 1943, and since June 15, 1943, indexes are not yet available, we, the Joint Conference Board of the Seattle Building and Construction Trades Council, and the Seattle Construction Council, find that based upon the above increases an additional 10% of the basic wage of \$1.30 per hour, or 13c per hour, is applicable under the Master Agreement and addendums on all work on or after January 1, 1944, for the calendar year 1944.

We further agree that this increase shall be effective January 1, 1944, for the calendar year 1944

(Testimony of Elton Hickok.)

General Counsel's Exhibit No. 2—(Continued)
on all work—provided, however, that should the June 15, 1943, indexes show that the increase of 10.8 from March 15, 1942, to April 15, 1943, is reduced as of June 15, 1943, to less than 10 points by reason of Governmental action in furtherance of a "roll-back" in cost of living or other factors, the applicable increase shall be 5% of the basic wage, or 6½¢ per hour, effective January 1, 1944. All allowance and payment of increases, however, subject to such Governmental regulations then in effect which may be determinative of the rights of the parties. Should the right to pay an increase be delayed beyond January 1, 1944, by governmental regulations or action, the increase shall not be retroactive but will be paid only from the permissible date.

It is further agreed that should this 10-point increase in wages not be allowed by governmental agencies as determined under this Master Agreement, no decrease shall be made in wages until cost of living decreases to an index equal or below 5 points less than March 15, 1943, index of 114.3, or an index of 109.3 or less. Should governmental agencies grant only a portion increase in wages for 1944—then the index shall be established on a pro rata basis of the index increase over the period from March 15, 1942, to June 15, 1943, instead of March 15th index of 114.3.

Paragraph 4 of this contract shall remain in effect until January 1, 1948, unless notice is given

(Testimony of Elton Hickok.)

General Counsel's Exhibit No. 2—(Continued)
90 days prior to July 1, 1947, and shall renew itself from year to year thereafter, provided that wages shall be adjusted from time to time as provided for in Paragraph 4.

All other conditions of this Agreement shall take effect on July 1, 1943, and continue in effect thereafter from year to year until changed by the mutual agreement of the parties as provided herein. Proposed changes or modification of this Agreement shall be made by either party giving notice thereof in writing to the other party at least 90 days before July 1, and such notice shall specify the provisions desired to be changed and shall state the time and place at which negotiations may commence. The other party shall enter into negotiations not later than 30 days from the date of the receipt of said notice, after party has notified the other in writing of proposed modifications and changes in the Agreement. In the event no accord can be reached in the succeeding 60 days, arbitration as provided hereinafter shall be resorted to.

5. It is mutually agreed by the parties hereto that an Adjustment Board shall be established consisting of six (6) members to be selected by the party of the first part, and six (6) members to be selected by the party of the second part, and an equal vote to be had on all questions, three (3) from each side consisting a quorum.

5 (a) Said Adjustment Board shall meet within

(Testimony of Elton Hickok.)

General Counsel's Exhibit No. 2—(Continued)
forty-eight (48) hours on written request by either party to this Agreement.

6. It Is Further Agreed by both parties hereto that all disputes and grievances that cannot be speedily and amicably adjusted on the work shall be submitted to the accredited agents of the parties hereto, and if not adjusted by them shall be submitted to the Adjustment Board, whose decision shall be submitted in writing and be final and binding upon both parties. Pending such decision there shall be no strike or lockout, except that where non-Union men are employed the Party of the Second Part reserves the right to remove all Union men from the job. In the event the Adjustment Board shall be unable to reach an Agreement, the U. S. Department of Conciliation shall be given the opportunity to adjust the difficulty in a manner acceptable to both parties signatory hereto. If such adjustment cannot be reached both parties and the U. S. Department of Conciliation shall each appoint an umpire and their decision shall be final and binding upon both parties. The Umpire appointed by the U. S. Department of Conciliation to be satisfactory to both parties hereto.

* * *

8. Wage Scale: It is further agreed that the following wage scale is accepted and approved by both parties and shall continue during the life of this Agreement unless changed under the provisions

(Testimony of Elton Hickok.)

General Counsel's Exhibit No. 2—(Continued)
of Section 4. The classifications of employment and the wage scales applying thereto shall be in accordance with Schedule "A" attached hereto. Additions for the purpose of clarification or supplying omissions may be made from time to time by agreement between the interested parties hereto.

Except as mutually agreed to by both parties signatory hereto, the Party of the Second Part agrees that there shall be no rotation of men.

9. (a) It is further agreed that all members of the Party of the First Part hiring employees will employ none other than members of the Party of the Second part, as enumerated in Schedule "A" attached hereto entitled Wage Schedule.

9. (b) The Party of the Second Part agrees that it will require all employers, whether members of the Party of the First Part or not, to meet the conditions of Sections 7, 8 and 9 of this Agreement, and further to register and comply with the State Workmen's Compensation Act, the State Business or Occupation Tax Act, the State and Federal Social Security Acts and the State Unemployment Tax Act before the party of the Second Part will furnish men to such employer. It shall be the responsibility of the Party of the Second Part, to the best of its ability, to enforce a Union condition on all construction within the jurisdiction of said part, as defined in Paragraph 3.

(Testimony of Elton Hickok.)

General Counsel's Exhibit No. 2—(Continued)

9. (e) In consideration of the terms and covenants of this Agreement, the Party of the Second Part agrees that in the event of there being a shortage of men available for work covered by this Agreement, the Party of the Second Part shall give requirements for men of the members of the Party of the First Part preference over the requirements of contractors and builders who are not members of the Party of the First Part.

10. Working Conditions: It is further agreed that the following working rules or conditions are accepted and approved by both parties and shall continue during the life of this Agreement, unless changed under the provisions of Section 4. Additions for the purpose of clarification or supplying omissions may be made from time to time by Agreement between the interested parties thereto.

* * *

SEATTLE CONSTRUCTION
COUNCIL.

By /s/ ALTERTON,
/s/ J. M. BAILEY,
/s/ GEO. E. TURFEL,
/s/ A. F. SHEPHERD,
/s/ CHAUNCEY SHMOT.
/s/ A. B. DANIELS,
/s/ DON S. McNEUSEY,
/s/ JERRY J. WARD,

(Testimony of Elton Hickok.)

General Counsel's Exhibit No. 2—(Continued)

SEATTLE BUILDING & CONSTRUCTION
TRADES COUNCIL-CONFERENCE COM-
MITTEE.

By /s/ HARRY L. CARR,

/s/ RICHARD TRACEY,

/s/ R. BUCHANAN,

/s/ FRED SMITH,

/s/ E. J. GILL,

/s/ ROBERT GLYNN,

/s/ GEO. E. NETHERCUT,

/s/ H. V. BOWMAN,

/s/ DAVE P. McKILCOP,

/s/ W. TURNER,

/s/ CLYDE FERN,

/s/ WM. GAUNT.

Admitted in evidence September 6, 1950.

Q. (By Mr. Tillman): How does the Seattle Construction Council know what unions are bound by that agreement at any one time?

A. The members of the Building Trades Council are signatories to the agreement.

Q. And that is, they have each signed it? [26]

(Testimony of Elton Hickok.)

General Counsel's Exhibit No. 2—(Continued)

A. No, the Building Trades Council Committee has signed for their group. It provides that six from each group, the employers' group and the Building Trades Council, are the parties. That is provided for in the agreement. [27]

* * *

(The document heretofore marked General Counsel's Exhibit No. 3 for identification, was received in evidence.) [29]

* * *

GENERAL COUNSEL'S EXHIBIT No. 3

In accordance with the provisions of the Agreement now in effect between the Seattle Construction Council and Seattle Master Builders, representing the Employers, and the Seattle Building & Construction Trades Council, representing the Employees, the following are the minimum wage rates for the various classifications as set forth below—Effective January 1, 1950:

Craft Classification:	Minimum Wage Rate
Asbestos Workers.....	\$2.29½ per hour
Carpenters and Allied Trades:	
Carpenters	2.19½ per hour
Shinglers	2.28½ per hour
Floor Layers	2.29½ per hour
Bridge, Dock & Wharf	
Builders	2.24½ per hour
Pile Driver Men.....	2.24½ per hour

(Testimony of Elton Hickok.)

Pile Boom Men.....	2.29½ per hour
Cement Finishers (building) ..	2.19½ per hour
Bridge, Viaduct & Grade Crossings	2.22 per hour
Composition Workers	2.24½ per hour
Mastic Floor Layers.....	2.24½ per hour
Electrical Workers	2.39½ per hour
Electrical Helpers	1.79½ per hour

Iron & Steel Trades:

Bridge, Structural & Orna- mental Iron Workers, Rig- gers, Machinery Movers & Sheeters	2.39½ per hour
Reinforcing	2.19½ per hour

Laborers:

Building Laborers	1.79½ per hour
Concrete and Carpenters' Helpers	1.79½ per hour
Jackhammer	1.89½ per hour
Plasterers' Hod Carriers	2.04½ per hour
Bricklayers' Mortarmen	2.04½ per hour
Chimney & Veneer Work.....	2.04½ per hour
Base and Floor Machine Men.	1.84½ per hour
Side Sewerman	2.14½ per hour

Lathers:

Metal	2.39½ per hour
Wood	2.39½ per hour

(Testimony of Elton Hickok.)

Painters:

Painters	2.19½ per hour
Painters on Structural Steel and Bridges	2.32 per hour
Sign Painters	2.49½ per hour
Linoleum Layers, Asphalt Tile Layers and Resilient Floor Layers	2.11½ per hour

Plaster Trades:

Plasterers	2.49½ per hour
Casters	2.04½ per hour
Modelers	2.64½ per hour
Model Makers	2.18 per hour
Roofers	2.19½ per hour
Sheet Metal Workers.....	2.34½ per hour
Sandblasters	2.64 per hour

Admitted in evidence September 6, 1950.

 OLIVER GAGNER

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows:

Direct Examination

* * *

By Trial Examiner Wilson:

Q. What is your occupation?

A. I am Secretary and Business Agent for Local No. 7. [30]

(Testimony of Oliver Gagner.)

* * *

Q. Now, Mr. Gagner, how many members are there in Local No. 7? A. Approximately 41.

Q. Has that number varied in any degree from oh, say, for the last three years?

A. No, not too much; just might vary one or two.

* * *

Q. In your insulation trade how does a member get a job if he is out of work?

A. Through the union.

Q. And what steps does he take?

A. He applies to the union, to the Business Agent.

Q. And what do you as Business Agent do when you get such a call?

A. If there is work I dispatch the man. If there is no work, why it is just too bad. [32]

* * *

Q. Do you have any so-called permit people at the present time? A. No.

Q. In the past have you obtained jobs for permit people? A. Yes.

* * *

SIDNEY ARTHUR LENNOX

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows: [33]

Direct Examination

By Mr. Tillman:

(Testimony of Sidney Arthur Lennox.)

* * *

Q. What is your occupation?

A. At present I am a farmer.

Q. Were you ever employed in the insulation trade business? A. Yes, I was.

Q. And what sort of work did you do?

A. General insulation, meaning on ships, that is covering pipes and boilers.

Q. Over what period of time did you engage in that sort of work?

A. Well, I believe I started September 17, 1942. [34]

* * *

Q. Have you ever been a member of the local?

A. No, I have not.

Q. Did you ever apply for membership?

A. Yes, I have, twice.

Q. When did you the first time?

A. I am not certain of the date, but I think it was in 1947, the first time.

* * *

Q. And were you advised subsequently what action had been taken?

A. I was advised by a member that it was put on file. No action taken.

Q. When was the second time?

A. I believe it was approximately a year later. I haven't kept track of the dates. [35]

* * *

Q. In the course of your employment in the in-

(Testimony of Sidney Arthur Lennox.)

sulation trade, did you pay any dues or other moneys to the local?

A. Yes, I paid permit fees for—on a percentage basis—for a period of three or four years. [36]

* * *

Q. When were you last employed by the Brower Company?

A. I think it was September 10th of last year. September 10th of last year.

Q. After that date did you seek any other employment in the industry?

A. Yes, I have done——

* * *

Q. With whom did you seek employment?

A. I phoned Ben Bradley to see if there——

Q. Who is Ben Bradley?

A. He is the foreman for Charles R. Brower.

Q. And when did you phone him?

A. I phoned him in January—I don't recall what date it was, but it was the early part of January, and I asked if there was any work being done, and he informed me there was, and to get clearance, and if I could, that he had work for me.

Q. What, if anything, did you do after your conversation with Bradley?

A. I immediately phoned Oliver Gagner and was denied [37] clearance.

Q. Well, what was your conversation with Gagner?

A. Well, I don't really recall at the time, but

(Testimony of Sidney Arthur Lennox.)

he said, at the time, that he was bringing in men from Portland and Bremerton, and that there was no work for permit men. That was the general gist of the conversation. I don't remember it word for word.

Q. And what had you told Gagner?

A. That there was, that there was work for me to do, and could I have a permit card to do the work.

Q. Did you tell him where there was work?

A. Not in that conversation. No, I didn't.

Q. Did you at any time tell him?

A. Yes, I did, two weeks later when I had occasion to call him again. That time I mentioned the specific ship and the company, and that there was work there for me to do if I could get clearance. It hinged largely on his clearance—you know what I mean—it hinged on his clearance.

Q. What was the reply?

A. He again replied he wasn't prepared to put permit men to work and he was getting ample men from Portland and Bremerton.

Q. Now, before this time, which you have just testified about, during the time you were working in the industry, if one job was finished, how did you go about getting a job somewhere else in the industry?

A. We went through the same procedure I just outlined. We phoned the shop to see if there was work—that is, we phoned [38] the shop's representative, Mr. Bradley, to see if there was, and if

(Testimony of Sidney Arthur Lennox.)

there was work, we phoned whoever was the Business Agent at that time for clearance to go on that job, or whichever job, or whichever shop.

Q. Had you ever worked without clearance?

A. No, I never have.

* * *

Cross-Examination

By Mr. Gill: [39]

* * *

Q. How long did you work on that type of work, commencing at the shipyards, September, 1942?

A. How long?

* * *

Q. Six years is the total spread?

A. Six years is the total time worked.

Q. Total time worked in different shipyards then?

A. And a little uptown work, too.

Q. A little uptown work, and when did the six-year period end?

A. September 10th, last year. [43]

* * *

Q. And was there somebody in each instance there who was a skilled person, having had many years of experience, that showed you what the work was?

A. In most cases. Not in all. [44]

Q. We are referring to uptown jobs?

A. I am referring to uptown jobs, also.

Q. Well, how many of those uptown jobs were you able to do without somebody showing you how to do them?

(Testimony of Sidney Arthur Lennox.)

A. I was able to do them all. I worked with others who were running the job or who were looking after the job, but I was quite able to do my own work. [45]

* * *

Trial Examiner Wilson: Mr. Lennox, you say you are—you say your work ended on September 10, 1949?

The Witness: That is correct.

Trial Examiner Wilson: Would you tell me how it happened to end at that time?

The Witness: I was laid off at that time for lack of work. [46]

* * *

TOIVIE E. ESKOLA

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows: [47]

Direct Examination

* * *

Q. Were you ever employed in the insulation trade? A. Yes.

Q. And over what period of time?

A. Approximately, I would say 9½ years.

Q. What would be the start of that period?

A. I don't remember the dates, but it was approximately two years before the war started, World War II. [48]

* * *

(Testimony of Toivie E. Eskola.)

Q. Are you a member of Local 7?

A. No.

Q. Were you ever a member? A. No.

Q. Did you ever apply for membership?

A. Yes.

* * *

Q. Were you advised of what the outcome had been on your application?

A. Well, what I understood on it, it was just brought up to have it throwed out and somebody seconded it, and it was throwed out. [49]

* * *

Q. Did you pay any dues or moneys to the local?

A. Yes, I paid all during the war, and before the war, and then we—they charged us after the war, when Harigel was Business Agent, they charged us \$3.00 a month.

* * *

Q. Now, when was the last time that you worked in the insulation trade? [50]

A. I was laid off February 8th.

Q. What year? A. 1950.

Q. What company were you working for then?

A. Brower and Company.

Q. And what particular job, if you remember?

A. I think it was—the ship's name—it was the Freeman.

Q. What sort of a ship was it?

A. It was a transport, a troop transport or a

(Testimony of Toivie E. Eskola.)

hospital ship at that time. I don't just remember.

* * *

Q. And is he the one that's been identified as foreman? A. Yes, he was foreman.

Q. And when Bradley laid you off who was present at the time? A. President?

Q. Who was present? Who was around?

A. Well, Kangas was there. We were together.

Q. What was the conversation then between yourself and Bradley in relation to your [51] lay-off?

A. Well, the general practice is that, the way they have it, the Asbestos Workers, they have an agreement that the permit men go off first and then travelers and then the card men. So that when the layoff come, it was us guys to go off.

* * *

Q. Were other employees kept on, working, after you were laid off?

A. No, all the permit men were let loose.

Q. Well, were there other employees kept on?

A. Oh, yes.

* * *

Q. As far as seniority on the job is concerned, were there men kept on the job who had been placed on the job after you had been?

A. Oh, yes.

Q. As far as that particular job on the transport was concerned, how early had you been hired on the job?

(Testimony of Toivie E. Eskola.)

A. I think I was about the first or second man on the job.

Q. You were?

A. I was, and I think Al Vollan was on. That's just about, [52] around in there, first or second or third man.

Q. Did you try to get any jobs in the trade after your layoff?

A. Yes, I called Oliver Gagner and asked him if he needed men.

Q. When was that?

A. I don't remember the date, but it was at least a couple of months after I got laid off, and I didn't have anything to do, and he told me he ordered men from Portland.

* * *

Q. What do you mean by that?

A. Well, card men, I guess, from Portland to take the place.

* * *

Q. Did you ever work without obtaining a clearance from a Business Agent? A. Never have.

* * *

Cross-Examination

By Mr. Gill: [53]

* * *

Q. The type of insulating work you do, there isn't too much to it?

A. Any insulation work, there isn't too much to it.

(Testimony of Toivie E. Eskola.)

Q. All the jobs you have had have been simple jobs? [55]

A. No, they have not. I have done the regular work, the same as the rest of them have done.

Q. That is providing there is someone there that can show you what to do and somebody there to watch you, and you can watch them?

A. No, I have worked alone, and if you want to check, I was a foreman for V. S. Jenkins at Everett Pacific, and I had card men working under me.

* * *

Q. How many men did you have under you?

A. At times I had as high as 10 and as high as 30, I think, there were one time. [56]

* * *

Q. During this time that you did insulation work, there was available carpenter work, at that time, getting the mechanic carpenter's rate?

A. I'd fill in when there was no work, I'd fill in, but during the war I worked steady at [58] insulation.

* * *

Redirect Examination

By Mr. Tillman: [60]

* * *

Trial Examiner Wilson: Mr. Eskola, what was your usual procedure after you had been laid off of one job? What did you do next?

The Witness: Well, I usually always went home

(Testimony of Toivie E. Eskola.)

and done what work I had to do at home, and called up and asked for other work.

Trial Examiner Wilson: How long would you lay off?

The Witness: Oh, sometimes, two three days; maybe a week. Depend on how the holidays would break in between. [61]

* * *

Trial Examiner Wilson: Was there any insulation work to be done at that time, talking now about February, 1950?

The Witness: There was work to be done at the time because I called Ben Bradley, and he said there was work, but we couldn't get clearance, and that's why I called Gagner.

* * *

Trial Examiner Wilson: Let me ask you this: Between the time you were laid off in February until this time, two months later, did you ever call Gagner asking for work?

The Witness: Yes. [62]

Trial Examiner Wilson: You did?

The Witness: Yes. [63]

* * *

UHRO A. KANGAS

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows:

Direct Examination

By Trial Examiner Wilson:

* * *

Q. Your present occupation?

A. Piledriver.

Q. Were you ever employed in the insulation trade? A. Yes.

Q. Over what years?

A. Oh, it must have been '43 when I [64] started.

* * *

Q. Down to when?

A. Until February 8, off and on.

* * *

Q. Are you a member of Local No. 7?

A. No, I am not.

Q. Were you ever a member? A. No.

Q. Did you ever apply for membership?

A. Yes.

Q. When?

A. Oh, I can't recall—I believe it was in the last part of '48 or first part of '49. [65]

* * *

Q. Were you advised of any decision being made on the application? A. No, I left it in there.

Q. Did anyone ever tell you what happened?

(Testimony of Uhro A. Kangas.)

A. Oh, well, what one of the members said, it was thrown in the garbage can.

Q. Did you pay any dues or other moneys to the Local 7? A. Yes, I have.

Q. And to whom did you pay your money?

A. To the Business Agent.

Q. Of Local 7?

A. Yes, and for a while I paid it to our local, the Piledrivers local.

* * *

Q. Now, you say you last worked there in the trade in February of 1950, and for what company were you working then? [66]

A. Charles R. Brower—Brower.

Q. What particular job were you working on?

A. Oh, a ship—Army Transport.

* * *

Q. And how were you notified that you were no longer, that you were out of a job?

A. Well, just called us and said, "I have to lay you guys off."

Q. Who did that? A. Ben.

Q. Ben who? A. Bradley. [67]

* * *

Q. And what did he say then?

A. Well, he said he had word from the Business Agent that he had to lay us off.

* * *

Q. Do you know whether any members were kept on the job who were put on the job after you were put on?

(Testimony of Uhro A. Kangas.)

A. Yes, there was some guys left.

Q. Were there any—strike that. Did the company have any other jobs available at the time you were laid off this job? A. Yes, there was.

Q. Were you advised of any such jobs?

A. Yes.

Q. By whom?

A. Ben. He said he could use us later on.

Q. Where? A. Down at Associated.

Q. Did you get on at Associated then?

A. No.

Q. Why?

A. Because we didn't have no permit to go.

Q. Did you apply for a permit?

A. Yes, afterwards. Oh, we was laid off on about—well, it was about a month after, and they said there was no work. [68]

* * *

Q. Did you make any other attempt to get any jobs in the insulation trade other than this one call to Gagner you mentioned?

A. Well, I kept on working at it to see what was going on, but as long as I didn't clear from the union, I didn't go to work. I wasn't a union member.

* * *

Q. Did you ever work without getting a permit? [69] A. No.

* * *

(Testimony of Uhro A. Kangas.)

Cross-Examination

By Mr. Gill: [70]

* * *

Q. You have seen other mechanics working at the same trade of insulation work who were doing harder jobs than you are able to do?

A. No, I'll do the same work as they do, and I have been doing it right with them, yes.

Q. You say you can do any kind of work that any mechanic can do at that trade?

A. Yes. [76]

* * *

Trial Examiner Wilson: Mr. Ben Bradley, when he told you he had to lay you off because he had word from a Business Agent, did he tell you what Business Agent he was talking about?

The Witness: Yes, Gagner. He said Gagner said he's got to lay us off. [78]

* * *

ALFRED J. VOLLAN

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Tillman: [79]

* * *

Q. Have you ever worked in the insulation trade?
A. Yes, I have.

(Testimony of Alfred J. Vollan.)

Q. And over what period of time?

A. I went to work in the fall of '42, not as a mechanic, as a helper. I worked as a helper nine months wherever—that would bring it in 1943, when I was moved up to mechanic.

Q. I see, and how long did you continue working as a mechanic in that trade?

A. I have—it's been my livelihood since that time, up until this last summer.

* * *

Q. Did you ever pay any dues to Local 7?

A. I have paid permit money during the war and after. During the war, on a one per cent [80] basis.

* * *

Q. When was the last time that you worked in the trade?

A. February 8th, I think it was, the last.

Q. What company were you working for?

A. Charles Brower.

Q. And what particular job?

A. On the Freeman on the waterfront.

Q. What sort of a ship was the Freeman?

A. It was a troop transport or an Army Transport.

Q. How did your employment come to an end on that day?

A. My foreman came around and told me that the Business Agent said it would be necessary for

(Testimony of Alfred J. Vollan.)

him to lay off the permit men, of which I was one of them.

Q. Who was your foreman?

A. Ben Bradley.

Q. Were any permit men kept on after you were laid off? A. No, not to my knowledge.

Q. Were any members of Local 7 kept on the job who did [81] not—who had not been hired on that job as early as you? A. Oh, yes.

* * *

Q. Did the company ever call you back to work?

A. No, not—they never called me again to work because the company can't do that. I was told at a **couple different times that there was work for me** if I could get a clearance.

Q. Who made such statements to you?

A. Ben Bradley.

Q. Do you remember about when they were made to you?

A. Well, once it was possibly about two weeks after the time when I was laid off, and the next time was about probably a month or five weeks later.

Q. Did you make any effort to get clearance on those occasions?

A. Yes, both times I called Mr. Gagner and asked him.

Q. What did you ask him?

A. I asked him if he would clear me for a job, and he said, "No," he was going to get all his men from out of town.

(Testimony of Alfred J. Vollan.)

Q. In the trade do they have any particular name for these people that come from out of town? How do you refer to them?

A. They're referred to as travelers. [82]

* * *

Q. Did you ever work without getting clearance or permit first?

A. No.

* * *

Cross-Examination

By Mr. Gill: [83]

* * *

Q. And considering all of your insulation experience what per cent would you say was shipyard work on the one hand and what per cent would you say is uptown work?

A. Well, I would say I have 2½ years uptown work.

Q. And how many years in shipyard—how many years shipyard?

A. I'd say about 4½. [86]

* * *

Q. Are you qualified, in your own estimation, to handle any mechanic's insulation job uptown or in a shipyard?

A. Yes, sir.

Q. Brower hasn't called for you for work since February, 1950, has he? Or, has the firm?

* * *

A. Brower has not called me, although I have talked to Brower's and they said they did have work, needed men, at those times. [87]

* * *

LEROY D. LUCY

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Tillman: [88]

* * *

Q. Over what period of time did you work in the insulation business?

A. Well, I think I first started in 1941.

Q. Down to when?

A. February 8, 1950. [89]

* * *

Q. What local? A. Asbestos Workers.

Q. Now, you testified that the last time you worked was February 8, 1950, in the insulation trade, and what company was that for?

A. Charles Brower.

Q. And what job were you working on?

A. I think it was the General Freeman, I guess.

Q. Was it the same job as Kangas and Vollan were on?

A. Yes, it was a conversion job. [90]

Q. How did your job come to an end as far as you, yourself, were concerned on that?

A. Well, the foreman came around and told me he'd have to lay me off.

Q. And who was your foreman?

A. He says it wasn't because there wasn't any work—but—Mr. Bradley was the foreman.

* * *

(Testimony of LeRoy D. Lucy.)

Trial Examiner Wilson: Did Mr. Bradley tell you what the reason was?

* * *

The Witness: Well, I think we were informed, and as I remember it, that there was work, but he couldn't keep us on because the Business Agent of the Asbestos Workers had requested that us permit men be laid off.

Q. Were any permit men kept on after the lay-off?
A. Not to my knowledge.

Q. And were you laid off before other members or before members of the local who had been hired on that job after you?
A. Yes, I was. [91]

* * *

Q. Did you ever try to get any jobs in the insulation trade after that?
A. Yes.

Q. And how did you make your attempts to get a job?

A. Well, I found out whether there was any work available first, and then I made application to the Business Agent by telephone.

* * *

Q. Who was the Business Agent?

A. Gagner.

* * *

Q. And what did you tell him? What did he say to you?

A. I asked if I could go on a certain job or get

(Testimony of LeRoy D. Lucy.)

a permit to work on a certain job or for a certain shop.

Q. What was his reply?

A. He said, "No," that he wasn't issuing any permits. [92]

* * *

MARVIN N. ROSAND

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows:

Direct Examination

* * *

By Mr. Tillman:

Q. And your occupation at present?

A. I am a piledriver now.

Q. Were you ever employed in the insulation trade? A. Yes.

* * *

Q. What period of time did you work?

A. Well, I started out in the fall of '43, I think it was.

Q. And down to when?

A. Down to last week in December of '49. [98]

* * *

Q. Did you ever pay any dues or moneys to the local? A. Yes, I paid.

Q. Under what arrangement did you pay moneys?

(Testimony of Marvin N. Rosand.)

A. Paid through our Business Agent of the Piledrivers.

* * *

Q. Were you also paying your regular dues to the Piledrivers? A. Yes.

Q. When were you last working in insulation trades, what company were you working for?

A. Brower.

Q. And what were you working on, any particular job?

A. I was working on boats—transports at the Port of Embarkation.

Q. How long had you been working on that particular job?

A. Just on there two days—just a short job.

Q. How did your employment come to an [99] end?

A. Well, they told me the Business Agent said he'd have to lay us off and replace us with travelers.

Trial Examiner Wilson: Who said that?

The Witness: Mr. Bradley.

* * *

Q. Did you make any attempt to get a job in the trade after your layoff?

A. No, I never bothered after that. I inquired around of the boys and they all said they were not giving out any permits since the new Business Agent took over the first of the year. It was told all around there was no more permits put out, so I never bothered.

(Testimony of Marvin N. Rosand.)

Q. Up until your final layoff there in December of 1949, how did you get a job in the insulation trade?

A. Well, the first one I got was sent out through the piledrivers. Asbestos Workers Local had called the Piledrivers for men.

* * *

Q. Did you ever have [100] a job in the insulation trade without having first obtained clearance or a permit?

A. No.

* * *

Cross-Examination

By Mr. Gill: [101]

* * *

Q. By reason of this nine months' experience in the uptown work, do you consider yourself qualified to do any of the uptown jobs?

A. Well, any of the jobs that one man can do, I can do them. [104]

* * *

BEN BRADLEY

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows:

Direct Examination

* * *

By Mr. Tillman:

Q. What is your occupation? [105]

(Testimony of Ben Bradley.)

A. I am the superintendent of Brower and Company.

Q. And how long have you been superintendent?

A. About five years—six years—going on six years.

* * *

Q. During the time that you have been superintendent, how have you gone about obtaining asbestos workers?

A. Well, I call the Business Agent for the number of men needed.

* * *

Q. Then what happens after that?

A. Then he send the men down to a given spot, if he has them available.

Q. And if they are not available you obtain them other places? A. No.

Q. What do you do?

A. Get along the best we can without them. [106]

* * *

Q. Were you here while Mr. Lennox testified?

A. Yes.

Q. If you recall, he testified that he last worked for the company in September, 1949. After that date, did he have any conversation with you with respect to finding another job with the company?

A. Well, yes, he called me.

Q. Do you remember when that conversation took place?

A. Oh, in the latter part of December and the

(Testimony of Ben Bradley.)

first part of January, and the first part of February.

Q. Were there any jobs available at that time or did you need any men? A. Yes, I did.

Q. Did you inform Mr. Lennox that you needed any asbestos workers? A. Yes.

Q. And what other conversation did you have at that time, if any, with him?

A. Well, I told him I had a call in for men, to get on the job if he could.

Q. Did Mr. Lennox get on the job?

A. No. [107]

Q. Did he ever talk with you after you had told him there were jobs available? A. Yes.

Q. And when was that?

A. Well, he called me from downtown here and asked me if I had got the men that I had called for, and I told him I hadn't yet.

* * *

Q. Well, was there any more conversation at that time?

A. Well, he asked me if I'd make a specific request for him to see if that would help him get on the job, and I told him I would.

Q. And did you? A. Yes, I did.

Q. Did—to whom did you make the request?

A. Mr. Gagner.

Q. And how soon after this conversation?

A. Well, the same day.

Q. Did Lennox ever report for work then?

A. No.

(Testimony of Ben Bradley.)

Q. What did Gagner say?

A. He said he wasn't going to put out any more permit men.

Q. Now, are you also acquainted with Mr. Eskola, Mr. Kangas, Mr. Vollan and Mr. Lucy?

A. Yes.

Q. The testimony has been that they were working on an Army Transport on about February 8, 1950, and you informed them that [108] they were being laid off. Is that substantially true?

A. Yes.

Q. What was the reason for laying off any men at that time?

A. To cut down the force of men.

Q. And why were these particular men selected for lay-off?

A. Because they were permit men.

Q. Now, why are permit men selected for lay-off?

A. Well, we have a regular procedure in our agreement with the local as to how we will lay off men, and I called the Business Agent the night before and told him I had to cut down in force and what would be the procedure, if it was still the same. He told me, "You better cut the permit men out first."

Q. Did you lay off all the permit men then on that job? A. Yes.

Q. Were employees kept on the job who had been hired for that job after some of these permit men?

A. Yes.

(Testimony of Ben Bradley.)

Q. Now, you also know Marvin Rosand?

A. Yes.

Q. Had he ever worked for the company before the two days he testified to? A. Oh, yes.

Q. Do you remember that he worked for you sometime in February, '49? A. Yes.

Q. And do you know how his employment was terminated? A. Yes, I laid him off.

Q. For what reason? [109]

A. Well, to replace him with a card man.

Q. How was it that you had to replace him with a card man?

A. Well, the Business Agent, Ben Kinzman, told me that he had a card man to replace Rosand with.

Q. How long had there been this practice of laying off permit men before regular members were laid off?

A. Well, that's always been the practice.

* * *

Q. Now, with reference to the abilities of some of these men that we have talked about here, are you familiar with Sidney Lennox's work as an asbestos worker? A. Yes.

Q. How about his qualifications? How would you characterize his work?

A. Well, he's a very good mechanic; he's one of the outstanding mechanics in the trade.

Q. How about Toivie Eskola? Are you familiar with his work? A. Yes.

Q. How would you rate him?

A. He's a very good mechanic. Very dependable.

(Testimony of Ben Bradley.)

Q. And are you familiar with Mr. Kangas' work? A. Yes. [110]

Q. How would you rate him?

A. He'd be one of the leaders.

* * *

Q. You are familiar with Mr. Lucy's work?

A. Yes.

Q. How would you rate him?

A. I would say he is way better than the average, or a good man.

Q. And Mr. Vollan?

A. Well, yes, he's a good mechanic. Very good mechanic.

Q. Are you also familiar with Mr. Rosand's work? A. Yes.

Q. How would you rate him?

A. He is a very good mechanic. [111]

* * *

Cross-Examination

* * *

By Mr. Gill:

Q. You have indicated the type of work that your firm does. Are all those six people qualified to do any of that work?

A. I believe they are, yes.

Q. Does that include your uptown work? [113]

A. Yes.

Q. They are qualified to do any of your uptown work? A. Yes, they are. [114]

* * *

(Testimony of Ben Bradley.)

Q. And some of them have testified that they have had very limited experience in uptown work. One man said that he had only worked nine months, Mr. Rosand, and you still think Mr. Rosand is qualified to do any uptown job?

A. I believe that he is. The ship work is much harder work. It takes much more skill than the uptown work does, and I believe that with all his experience in the shipyards that he is well qualified to do the work uptown. I say that with respect to the men they replace him with, that he is much better than those men. [115]

* * *

Redirect Examination

By Mr. Tillman:

* * *

Q. Do you happen to know the names of any other shipline companies that the company has done work for? We already have in the record, Luckenbach. Are there any other lines you can think of?

A. Oh, yes, there are the foreign lines, like the Swedish ships that come in. We do work for them. Intercoast, Oceanic, Weyerhaeuser. [118]

Q. Is that all you can think of?

A. There are several more, but I can't think of them now. [119]

* * *

Mr. Gill: No further questions.

Trial Examiner Wilson: Mr. Bradley, since De-

(Testimony of Ben Bradley.)

cember of 1949 or February of 1950, has there ever been a time when the Brower Company has had a request in for men which has not been filled by Local 7?

The Witness: Oh, yes, several times.

Trial Examiner Wilson: Have those requests remained unfilled for any length of time at all?

The Witness: Well, yes, and then when they did get men, they were absolutely green men or men from these B locals that didn't know anything about the work, that they would put on the job, but I have had pretty near a constant call since that time for men at all times. [120]

* * *

BEN L. KINSMAN

a witness called by and on behalf of Asbestos Workers Local No. 7, being first duly sworn, was examined and testified as follows:

Direct Examination

* * *

By Mr. Gill:

Q. Your place of residence?

A. 13831 Military Road.

Q. And you have been a Business Agent of the Asbestos Workers Local No. 7?

A. I finished the term that Harigel retired from. I served from, I think, the early part of November to January. [122]

* * *

(Testimony of Ben L. Kinsman.)

Q. Now, did you have any dealings with Mr. Bradley with respect to the termination of Rosand?

A. Yes, Mr. Bradley come down to the job where I was at and informed me that Rosand was working for them, and it was to my surprise that Rosand was working, and it came about that I told Bradley that there was lots of men available, and he asked about how he should go about laying Rosand off, and I said that was up to him, and I think it was agreed that Rosand should finish the job he was on, and there was no more call for laborers from the Brower shop.

* * *

Cross-Examination

By Mr. Tillman: [124]

* * *

Q. When he advised you that he had Rosand working for him, why did you tell him you had a lot of men available?

A. I told him there were a lot of men available at the present time.

Q. Why did you tell him that?

A. Because it was for his own information if he needed more men.

Q. Then, how did it come up to the discussion where you said it was up to Bradley whether to lay off those men?

A. That was—I don't know whether it was that Brower was low on men or what. I mean low on work or what, or how the discussion got around to

(Testimony of Ben L. Kinsman.)

laying Rosand off, but I do know I definitely did not order Rosand to be laid off.

Q. Why did the discussion come up? [127]

A. Well, because of the surplus of labor, probably.

Q. Why was it any concern of Bradley's that you have a surplus of labor?

A. Well, I don't know.

* * *

Trial Examiner Wilson: Which remark was made first, that they had a surplus of labor or that Rosand should be laid off?

The Witness: I imagine it was——

Trial Examiner Wilson: What is your recollection?

The Witness: I probably told Bradley that we had lots of men, help now.

Trial Examiner Wilson: And then do I understand from your answer that the question of laying Rosand off came up after you had told Bradley that there was—that there were a lot of men available?

The Witness: I should imagine so. [128]

* * *

OLIVER GAGNER

a witness called by and on behalf of Asbestos Workers Local 7, having been previously sworn, was examined and testified as follows: [130]

Direct Examination

* * *

(Testimony of Oliver Gagner.)

Q. Mr. Lennox testified that in 1947 and again about a year later he applied for membership in the union and that he was not given membership. What was the reason?

A. He couldn't qualify. He might qualify as far as one particular employer is concerned, but we look at it from the standpoint that it is our trade. It isn't the employer's trade. He can take his \$5,000 and start a hamburger stand, but we have built up this trade and must maintain it, and that is how we make our living, and so we have a standard to go by. Our men must qualify and anybody that puts in an application must do the same as I or anyone of the 41 other members or 42, whatever it might be, so we have always considered that we had that right.

Q. In what way did Lennox not qualify?

A. Well, he was primarily a waterfront man, and, oh, right at the time there is a little work down on the waterfront, but up until the time this Korea war started, she was pretty slim pickings. They were down to probably a half a man on the waterfront so that we don't pay too much attention to the waterfront work. Where we make our living is on the uptown work.

Q. Did Lennox qualify at the time he made the two applications for the uptown work?

A. No, he did not. [136]

* * *

Q. Calling your attention to Mr. Eskola, now, he testified that he applied for membership in Sep-

(Testimony of Oliver Gagner.)

tember, 1949, and was not given membership. What was the reason? A. Not qualified.

* * *

Q. Mr. Kangas testified that he applied for membership in the latter part of 1948 or the early part of 1949, and was not given membership. Now, he is a piledriver by trade. What was the reason for the rejection? A. Not qualified.

* * *

Q. It is my recollection that the remaining individuals, Vollan, Lucy and Rosand did not testify that they had made applications to join the union. Do you have any knowledge as to whether they did or not? A. I don't think they did. [137]

* * *

Q. Well, with respect to the Brower firm, has your union issued any instructions to the Brower firm that they must operate closed shop with your Local No. 7?

A. Well, the agreement was signed previous to the Taft-Hartley Law and says they will hire nobody but members of Local No. 7. That agreement was signed in the early part of '47. [143]

* * *

Cross-Examination

By Mr. Tillman:

Q. Mr. Gagner, since February 8, 1950, has Local 7 issued any permits to anybody?

Trial Examiner Wilson: Since when?

(Testimony of Oliver Gagner.)

Mr. Tillman: Since February 8, 1950.

A. No.

Q. * * * What year was that that you had once before been a Business Agent?

A. Oh, I would say around 1943—'44. Somewheres in there.

* * *

Q. At that time was your membership around 41 people? A. Oh, probably closer to 54, 55.

Q. At that time how many permit men did you have? A. Up to 350. [146]

* * *

Q. What is the last time that Local 7 took in a member? A. Last year. [149]

* * *

Q. Do you remember when the next-to-the-last member was taken in?

A. Oh, maybe several months previous to [150] that.

* * *

Trial Examiner Wilson: How does a man become qualified for membership in your organization, please?

The Witness: When he knows the trade thoroughly. In other words, we have an examining board composed of the [151] old-timers in the local, and they examine this man and there is no set rules. They can ask them questions or they can take them out on the job, or they could send him to work for an employer and check on his work.

(Testimony of Oliver Gagner.)

Trial Examiner Wilson: Were any of the three men who applied for membership in Local 7 given such an examination?

The Witness: No, for the reason that they are mainly or primarily waterfront men.

Trial Examiner Wilson: But the fact remains that none of them were given an examination?

The Witness: That is right. It was passed on in a general meeting.

Trial Examiner Wilson: What do you mean "it was passed on in a general meeting"?

The Witness: The application was submitted at a general meeting and a member voiced an objection or whatever it might be and that was it.

Trial Examiner Wilson: Well, then, the men were not turned down because they were not qualified?

The Witness: Yes, they were. A member objected to their qualifications, which is permissible in any kind of a local or a lodge or you might say anything. If there is an objection raised, that's permissible. It might be voted down. [152]

* * *

SIDNEY ARTHUR LENNOX

a witness called by and on behalf of General Counsel, having previously been sworn, was examined and testified as follows: [153]

Redirect Examination

* * *

By Mr. Tillman:

Q. With respect to comparing the skill required in uptown work with the skill required in shipyard work, what is your observation on that score?

A. Well, a ship is under a constant motion. Consequently there is a great deal of vibration, and it requires work that is going to stay on. In other words, a building is stationary. The work you put on here today will look the same tomorrow, but a ship is under constant vibration from the waves pounding on it and the movement of the motor and the engines tend to tear down any work that is done, and what work that is done has to be put on to last a considerable length of time.

Q. I see.

A. That goes through quite a rigid inspection for that reason. In other words, Mr. Gagner tried to point out that it is slap-stick work. It is anything but that. In repair work in some cases a boat comes in for a short period of time. It is in for two or three hours, and it is going to take, the repair work is going to have to be a hurry-up job, but it has to be a good job because it is going to protect those men from being burned, and not to

(Testimony of Sidney Arthur Lennox.)

keep out heat or cold. It is for protection, and we have to do a hurry-up job. But the basic [154] ship jobs are done on conversion jobs or new work or large repair jobs and are done with a great deal of skill, regardless of how that fact is torn down by Mr. Gagner. It still requires a lot of skill, a lot more skill than a lot of fellow-members have shown.

Q. Now, you mentioned inspection. Is there inspection of your work?

A. There is a great deal of inspection. [155]

* * *

BEN BRADLEY

a witness called by and on behalf of General Counsel, being previously sworn, was examined and testified as follows:

Redirect Examination

* * *

By Mr. Tillman:

Q. Mr. Bradley, you were present when Mr. Gagner testified concerning your call to him with respect to the layoff of February 8? A. Yes.

Q. And Mr. Gagner testified that he in effect left it up to [160] you to apply whatever policy you wanted to. Would you state why you applied the policy of laying off permit men first?

A. Well, because that was his orders in this way, that I asked him, "Shall we put both ourselves in the clear here and get a ruling from the International?" and he said, "Absolutely not," that he was

still running things in Seattle and that the permit men would come off first. He threatened strike action if they weren't taken off. [161]

* * *

[Title of Board and Cause.]

CERTIFICATE OF THE NATIONAL LABOR RELATIONS BOARD

The National Labor Relations Board, by its Executive Secretary, duly authorized by Section 102.87, Rules and Regulations of the National Labor Relations Board, Series 6, hereby certifies that the documents annexed hereto constitute a full and accurate transcript of the entire record of a proceeding had before said Board, entitled "In the Matter of International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, and Sidney Arthur Lennox (an Individual), and Toive Elmer Eskola (an Individual), and Uhro A. Kangas and Marvin N. Rosand (Individuals), and Seattle Construction Council (and its members), Party to the Contract," Cases Nos. 19-CB-91, 19-CB-95, 19-CB-97, before said Board, such transcript including the pleadings and testimony and evidence upon which the order of the Board in said proceeding was entered, and including also the findings and order of the Board.

Fully enumerated, said documents attached hereto are as follows:

(1) Order designating Thomas S. Wilson as Trial Examiner for the National Labor Relations Board, dated September 5, 1950.

(2) Stenographic transcript of testimony taken before Trial Examiner Wilson on September 6, 1950, together with all exhibits introduced in evidence.

(3) Respondent's letter dated September 8, 1950, requesting additional time for filing briefs before the Trial Examiner.

(4) Copy of Chief Trial Examiner's telegram dated September 13, 1950, granting all parties additional time for the filing of briefs.

(5) Copy of General Counsel's motion to correct transcript, dated September 22, 1950, together with affidavit of service.

(6) Trial Examiner Wilson's Order entitled "Motion," dated October 10, 1950, allowing corrections to be made in transcript of record, together with affidavit of service and United States Post Office return receipts thereof.

(7) Copy of Trial Examiner Wilson's Intermediate Report, dated October 18, 1950 (annexed to item 13 hereof); copy of order transferring case to the Board, dated October 18, 1950, together with affidavit of service and United States Post Office return receipts thereof.

(8) Respondent's application for oral argument, dated October 25, 1950 (denied in Board's Decision and Order of December 15, 1950).

(9) Respondent's exceptions to the Intermediate Report, received November 1, 1950.

(10) Copy of the Decision and Order issued by the National Labor Relations Board on December 15, 1950, with Intermediate Report annexed, together with affidavit of service and United States Post Office return receipts thereof.

(11) Respondent's petition for reconsideration and petition to reopen record, dated December 22, 1950.

(12) General Counsel's motion for reconsideration of Board remedy and order and reply to "Respondent's petition for reconsideration and petition to reopen record," dated December 27, 1950, together with affidavit of service and United States Post Office return receipts thereof.

(13) Copy of Board's Order denying petition and motion, dated January 17, 1951.

In Testimony Whereof, the Executive Secretary of the National Labor Relations Board, being thereunto duly authorized as aforesaid, has hereunto set his hand and affixed the seal of the National Labor Relations Board in the city of Washington, District of Columbia, this 17th day of October, 1951.

/s/ FRANK M. KLEILER,
Executive Secretary.

[Seal] NATIONAL LABOR
RELATIONS BOARD.

[Endorsed]: No. 13139. United States Court of Appeals for the Ninth Circuit. National Labor Relations Board, Petitioner, vs. International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, A.F.L., Respondent. Transcript of Record. Petition for Enforcement of Order of the National Labor Relations Board.

Filed October 19, 1951.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for
the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

13139

NATIONAL LABOR RELATIONS BOARD,
Petitioner,

vs.

INTERNATIONAL ASSOCIATION OF HEAT
AND FROST INSULATORS AND ASBES-
TOS WORKERS, LOCAL No. 7, AFL,
Respondent.

PETITION FOR ENFORCEMENT OF AN OR-
DER OF THE NATIONAL LABOR RELA-
TIONS BOARD

To the Honorable, the Judges of the United States
Court of Appeals for the Ninth Circuit:

The National Labor Relations Board, pursuant to the National Labor Relations Act, as amended (61 Stat. 136, 29 U.S.C., Supp. IV, Secs. 151, et seq.), hereinafter called the Act, respectfully petitions this Court for the enforcement of its order against Respondent, its officers, representatives, agents, successors, and assigns. The proceedings resulting in said order are known upon the records of the Board as "In the Matter of International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, and Sidney Arthur Lennox (An Individual) and Toive Elmer Eskola (An Individual) and Uhro A. Kangas and Marvin N. Rosand (Individuals) and Seattle Con-

struction Council (and its members) Party to the **Contract, Cases Nos. 19-CB-91, 19-CB-95, and 19-CB-97.**”

In support of this petition the Board respectfully shows:

(1) Respondent is a labor organization engaged in promoting and protecting the interest of its members in the State of Washington, within this judicial circuit where the unfair labor practices occurred. This Court therefore has jurisdiction of this petition by virtue of Section 10 (e) of the National Labor Relations Act, as amended.

(2) Upon all proceedings had in said matter before the Board as more fully shown by the entire record thereof certified by the Board and filed with this Court herein, to which reference is hereby made, the Board on December 15, 1950, duly stated its findings of fact and conclusions of law, and issued an order directed to the Respondent, its officers, representatives, agents, successors and assigns. The aforesaid order provides as follows:

ORDER

Upon the entire record in the case, and pursuant to Section 10 (c) of the National Labor Relations Act, as amended, the National Labor Relations Board hereby orders that the Respondent, International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, its officers, representatives, agents, successors, and assigns, shall:

1. Cease and desist from:

(a) Requiring the enforcement of its existing contract with Seattle Construction Council containing illegal union-security provisions and causing Seattle Construction Council and its members, including Chas. R. Brower & Co., to discriminate in regard to the hire and tenure of employment of persons who are not members of the Union or who have been refused membership in said Union for reasons other than their failure to tender the periodic dues and initiation fees, in violation of Section 8 (b) (2) of the Act;

(b) Restraining or coercing employees or prospective employees in the exercise of their right to refrain from any and all concerted activities listed in Section 7 of the Act, except to the extent that such rights may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized by Section 8 (a) (3) of the Act.

2. Take the following affirmative action which the Board finds will effectuate the policies of the Act:

(a) Notify Seattle Construction Council and its members, including Chas. R. Brower & Co., that it no longer considers the union-security provisions of the contract between it and said Council to be in effect or binding upon the parties;

(b) Notify Seattle Construction Council and its members, including Chas. R. Brower & Co., in writing, and furnish copies of said notice to the

individuals involved, that it withdraws its objections to the employment of Sidney A. Lennox, Toive E. Eskola, Uhro A. Kangas, Alfred Vollan, LeRoy Lucy, and Marvin N. Rosand, and that it has no objection to the employment of said individuals;

(c) Make whole the said Sidney A. Lennox, Toive E. Eskola, Uhro A. Kangas, Alfred Vollan, LeRoy Lucy, and Marvin N. Rosand for any loss of pay that each may have suffered by reason of the Respondent's discrimination against him, in the manner provided herein and in the section of the Intermediate Report entitled, "The remedy";

(d) Post immediately in its business office and wherever notices to its members are customarily posted, copies of the notice attached hereto marked Appendix A.⁴ Copies of said notice, to be furnished by the Regional Director for the Nineteenth Region shall, after being duly signed by an official representative of the Respondent Union, be posted by it immediately upon receipt thereof and be maintained for a period of at least sixty (60) consecutive days thereafter in conspicuous places, including all places where notices to members are customarily posted. Reasonable steps shall be taken by the Respondent Union to insure that said notices are not altered, defaced, or covered by any other material;

(e) Notify the Regional Director for the Nineteenth Region in writing, within ten (10) days from

⁴In the event that this Order is enforced by decree of a United States Court of Appeals, there shall be inserted before the words, "A Decision and Order," on this notice the words, "A Decree of the United States Court of Appeals Enforcing."

the date of this Order, what steps it has taken to comply herewith.

(3) On December 15, 1950, the Board's Decision and Order was served upon Respondent by sending a copy thereof postpaid, bearing Government frank, by registered mail, to Respondent's counsel.

(4) Pursuant to Section 10 (e) of the National Labor Relations Act, as amended, the Board is certifying and filing with this Court a transcript of the entire record of the proceeding before the Board, including the pleadings, testimony and evidence, findings of fact, conclusions of law, and order of the Board.

Wherefore, the Board prays this Honorable Court that it cause notice of the filing of this petition and transcript to be served upon Respondent and that this Court take jurisdiction of the proceeding and of the questions determined therein and make and enter upon the pleadings, testimony and evidence, and the proceedings set forth in the transcript and upon the order made thereupon as set forth in paragraph (2) hereof, a decree enforcing in whole said order of the Board, and requiring Respondent, its officers, representatives, agents, successors and assigns to comply therewith.

NATIONAL LABOR
RELATIONS BOARD.

By /s/ A. NORMAN SOMERS,
Assistant General Counsel.

Dated at Washington, D. C. this 17th day of October, 1951.

APPENDIX A

Notice

To All Members of International Brotherhood of
Heat and Frost Insulators and Asbestos Work-
ers Union, Local No. 7, AFL

Pursuant to
A Decision and Order
of the National Labor Relations Board, and in order
to effectuate the policies of the National Labor Re-
lations Act, we hereby notify you that:

We Have notified Seattle Construction Council
and its members, including Chas. R. Brower & Co.,
that the union-security provisions contained in our
contract with them are no longer binding and of any
effect and that they are free to employ the follow-
ing individuals:

Sidney A. Lennox

Toive E. Eskola

Uhro A. Kangas

Alfred Vollan

LeRoy Lucy

Marvin N. Rosand

We Will make whole the above-named individuals
for any loss of pay suffered because of the discrimi-
nation against each of them.

We Will Not restrain or coerce employees or
prospective employees of employer members of
Seattle Construction Council, including Chas. R.
Brower & Co., or any other employer, in the exer-
cise of their right to refrain from engaging in con-

certed activities as guaranteed them by Section 7 of the Act, except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment, as authorized in Section 8 (a) (3) of the Act.

We Will Not in any manner cause or attempt to cause Seattle Construction Council and its members, including Chas. R. Brower & Co., or any other employer, to discriminate against any employee or prospective employee in violation of the Act.

International Brotherhood of Heat and Frost Insulators and Asbestos Workers Union, Local No. 7, AFL,

.....,

(Union).

Dated

By,

(Representative) (Title)

This notice must remain posted for 60 days from the date of posting, and must not be altered, defaced, or covered by any other material.

[Endorsed]: Filed October 19, 1951.

[Title of Court of Appeals and Cause.]

STATEMENTS OF POINTS RELIED UPON
BY THE BOARD

To the Honorable, the Judges of the United States
Court of Appeals for the Ninth Circuit:

Comes now the National Labor Relations Board, the petitioner herein, and, in conformity with Rule 19 (6) of the rules of this Court, files this statement of points upon which it intends to rely in the above-entitled proceeding:

I. The Board properly found that the employer here involved is engaged in operations affecting commerce within the meaning of the Act.

II. Substantial evidence on the record considered as a whole supports the Board's conclusion that Respondent pursuant to the illegal union-security agreement required the employer to lay off or refuse to hire the six named employees in violation of Section 8 (b) (2) and 8 (b) (1) (A) of the Act.

III. The Board's order is valid and proper.

/s/ A. NORMAN SOMERS,
Assistant General Counsel.

NATIONAL LABOR
RELATIONS BOARD.

Dated at Washington, D. C., this 17th day of October, 1951.

[Endorsed]: Filed October 19, 1951.

[Title of Court of Appeals and Cause.]

ORDER TO SHOW CAUSE

United States of America—ss.

The President of the United States of America

To International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, Att: Mr. Oliver Gagner, 13709 15th Ave., N.E., Seattle, Washington, and Seattle Construction Council, Att: Mr. Josef Diamond, Hoge Bldg., Seattle, Washington.

Greeting:

Pursuant to the provisions of Subdivision (e) of Section 160, U.S.C.A. Title 29 (National Labor Relations Board Act, Section 10 (e)), you and each of you are hereby notified that on the 19th day of October, 1951, a petition of the National Labor Relations Board for enforcement of its order entered on December 15, 1950, in a proceeding known upon the records of the said Board as

“In the Matters of International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, and Sidney Arthur Lennox (An Individual); and Toive Elmer Eskola (An Individual), and Uhro A. Kangas and Marvin N. Rosand (Individuals), and Seattle Construction Council (and its members) Party to the Contract, Cases Nos. 19-CB-91; 19-CB-95; 19-CB-97.”

and for entry of a decree by the United States Court

of Appeals for the Ninth Circuit, was filed in the said United States Court of Appeals for the Ninth Circuit, copy of which said petition was attached hereto.

You are also notified to appear and move upon, answer or plead to said petition within ten days from date of the service hereof, or in default of such action the said Court of Appeals for the Ninth Circuit will enter such decree as it deems just and proper in the premises.

Witness, the Honorable Fred M. Vinson, Chief Justice of the United States, this 19th day of October in the year of our Lord one thousand, nine hundred and fifty-one.

[Seal] /s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for
the Ninth Circuit.

Return on Service of Writ attached.

[Endorsed]: Filed November 9, 1951.

No. 13139

**In the United States Court of Appeals
for the Ninth Circuit**

NATIONAL LABOR RELATIONS BOARD, PETITIONER

v.

**INTERNATIONAL ASSOCIATION OF HEAT AND FROST
INSULATORS AND ASBESTOS WORKERS, LOCAL No. 7,
AFL, RESPONDENT**

**ON PETITION FOR ENFORCEMENT OF AN ORDER OF THE NA-
TIONAL LABOR RELATIONS BOARD**

BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

GEORGE J. BOTT,

General Counsel,

DAVID P. FINDLING,

Associate General Counsel,

A. NORMAN SOMERS,

Assistant General Counsel,

BERNARD DUNAU,

HENRY GELLER,

Attorneys,

National Labor Relations Board.

FILED

FEB 18 1952

PAUL B. O'BRIEN

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**In the United States Court of Appeals
for the Ninth Circuit**

No. 13139

NATIONAL LABOR RELATIONS BOARD, PETITIONER

v.

INTERNATIONAL ASSOCIATION OF HEAT AND FROST
INSULATORS AND ASBESTOS WORKERS, LOCAL No. 7,
AFL, RESPONDENT

*ON PETITION FOR ENFORCEMENT OF AN ORDER OF THE NA-
TIONAL LABOR RELATIONS BOARD*

BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

JURISDICTION

This case is before the Court on petition of the National Labor Relations Board pursuant to Section 10 (e) of the National Labor Relations Act, as amended,¹ for enforcement of its order of December 15, 1950, issued against the International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, herein called the Union, following the usual

¹ 61 Stat. 136, 29 U.S.C. Supp. IV, Secs. 151, *et seq.* Relevant portions of the Act appear in the appendix, *infra*, pp. 21-23.

proceedings under Section 10 of the Act. This Court has jurisdiction of these proceedings under Section 10 (e) of the Act, the unfair labor practices having occurred within this judicial circuit at Seattle, Washington. The Board's decision and order (R. 45-54, 20-44) ² are reported at 92 NLRB 753.

STATEMENT OF THE CASE

I. The Board's Findings of Fact

A. The Commerce Data

E. E. Saberhagen, an individual doing business as Chas. R. Brower and Co., herein called the Company, is engaged in Seattle, Washington in the distribution and installation of insulating materials used in building construction and upon seagoing vessels (R. 22-23; 62-63). At various shipyards located in Washington, the Company during its 1949 fiscal year installed insulation material on seagoing vessels belonging to concerns engaged in interstate commerce, such as Luckenbach Steamship Company, Northland Transportation Company, and the Army Transport Service (R. 23; 62-64). It also did insulation work in industrial and building construction projects in Seattle and in Portland, Oregon (R. 23; 62, Tr. 22).³ During the year 1949, it purchased goods and materials valued at approximately \$200,000, of which 90 percent came from outside the State of Washington, and it received a gross income

² References to portions of the printed record are designated "R." Those references preceding a semi-colon are to the Board's findings and those following a semi-colon are to the supporting evidence.

³ "Tr." refers to occasional references to the original transcript of the testimony certified to the Court but not included in the printed record.

from its installation work in excess of \$500,000 (R. 23; 11, 18, 63-64). Of its income, about \$60,000 was for materials furnished and services rendered on vessels, 90 percent of which moved in interstate and foreign commerce (R. 23; 63-65, 105). In addition, the Company was a member of an association-wide bargaining group of employers (*infra*, p. 4). The Board found that the operations of the Company affect commerce so as to confer jurisdiction on the Board to redress unfair labor practices obstructing them (R. 23).⁴

⁴ In view of the magnitude of the interstate and foreign facets of the Company's commerce, the Board's assertion of jurisdiction was clearly proper. *N.L.R.B. v. Denver Building Trades Council*, 341 U.S. 675, 683-685; *Local 74 v. N.L.R.B.*, 341 U.S. 707, 712; *I.B.E.W. v. N.L.R.B.*, 341 U.S. 694, 699; *N.L.R.B. v. Townsend*, 185 F. 2d 378, 381-383 (C.A. 9), certiorari denied, 341 U.S. 909.

Before the Board, the Union argued that, because the Company official who testified could remember the precise figures on only one specific job (R. 64-65), the record showed a figure of only \$6,000 as services performed on ships carrying interstate and foreign commerce. Aside from the fact that this contention ignores the Company's \$180,000 extra-state purchases, the work done in Portland, Oregon, and its membership in an association-wide group, alone sufficient for jurisdictional purposes, the contention is unsound. Although the witness either did not know the various owners or could not "give any exact figure" for individual concerns (R. 64-65), he did testify that he knew the vessels worked on to be of "a large type . . . engaged in offshore and intercoastal trade" (R. 65) and that 90 percent of the Company's shipyard work was on such seagoing vessels (R. 63, 64).

The Union also argued that the restrictive closed-shop provisions of the contract, which gave rise to the discrimination involved in this case, had not been applied to jobs affecting commerce. Nothing in the record supports this assertion, and in view of the fact that the terms of the contract have been fully applied to insulation jobs being performed on ocean-going vessels, as exemplified by the discrimination against the six employees in this case (*infra*, pp. 7-10), this contention is factually without merit (R. 32). In any event, an integrated enterprise cannot be divided into its local and interstate facets so as to defeat the exertion of jurisdiction in the interstate part considered in isolation. *Hearst Publications v. N.L.R.B.*, 136 F. 2d 608, 610 (C.A. 9), affirmed in this respect, 322 U.S. 111.

Finally, addressing itself to the Board's discretion to decline jurisdiction (*Haleston Drug Stores, Inc. v. N.L.R.B.*, 187 F. 2d 418

B. Background to the Unfair Labor Practices

The unfair labor practices in this case pertain to the discrimination in employment practised by the Union against non-members pursuant to an invalid closed-shop agreement. Accordingly, it is necessary at the outset to state, (1) the terms of the closed-shop agreement, and (2) the system of employment which prevailed.

1. *The closed-shop agreement*

The Company is a member of the Seattle Construction Council, an association of employers of craftsmen and labor which acts collectively in labor relations for its members (R. 23; 65-66, 73-74). On June 30, 1943, the Seattle Construction Council, representing all of its members including the Company, entered into an agreement with Seattle Washington Buildings and Construction Trades Council, an association of construction labor organizations of which the Union is one (R. 24; 66-72). Under paragraph 9-a of this contract, it was agreed that the employers would "employ none other than members of the Party of the Second Part [Trades Council], as enumerated in Schedule 'A' attached hereto entitled WAGE SCHEDULE" (R. 24; 71). Included in this schedule was the work classification of

(C.A. 9), certiorari denied, 342 U.S. 815), the Union unsuccessfully urged the Board not to assert jurisdiction in this case. As this Court has held, "Providing that the Board acts within its statutory and constitutional power, it is not for the courts to say when that power should be exercised." *N.L.R.B. v. Townsend*, 185 F. 2d 378, 383 (C.A. 9), certiorari denied, 341 U.S. 909; see also, *International Brotherhood of Electrical Workers v. N.L.R.B.*, 181 F. 2d 34, 36-37 (C.A. 2), affirmed 341 U.S. 694, 699; *N.L.R.B. v. Mid-Co Gasoline Co.*, 183 F. 2d 451, 453 (C.A. 5).

“asbestos workers,” the group represented by the Union (*ibid*).

This agreement contained an escalator or cost-of-living wage clause by which wages were to be determined for the period from January 1, 1944 through January 1, 1947 (R. 24; 66-68). The duration clause applicable to this escalator wage provision reads as follows (R. 25; 68-69):

Paragraph 4 [escalator wage provision] of this contract shall remain in effect until January 1, 1948 unless notice is given 90-days prior to July 1, 1947 and *shall renew itself from year to year thereafter*,—Provided that wages shall be adjusted from time to time as provided for in Paragraph 4. (Emphasis supplied.)

The duration clause pertaining to all other employment conditions specified by the contract provides as follows (R. 25; 69):

All other conditions of this Agreement shall take effect on July 1, 1943, and *continue in effect thereafter from year to year* until changed by the mutual agreement of the parties as provided herein. Proposed changes or modifications of this Agreement shall be made by either party giving notice thereof in writing to the other party at least 90-days before July 1, and such notice shall specify the provisions desired to be changed and shall state the time and place at which negotiations may commence. The other party shall enter into negotiations not later than 30-days from the date of the receipt of said notice, after party has notified the other in writing of proposed modifications and changes in this Agreement. In the event no accord can be reached

in the succeeding 60-days, arbitration as provided hereinafter shall be resorted to. (Emphasis supplied.)

The method of arbitration provided that, upon the exhaustion of certain intermediate steps without reaching agreement, three umpires were to be selected, one by each party and a third by the U. S. Department of Conciliation whose choice had "to be satisfactory to both parties," and the umpires' decision was to "be final and binding upon both parties" (R. 26; 70).

Through the date of the hearing before the trial examiner, held on September 6, 1950, this agreement remained in full force and effect without any modification (R. 26; Tr. 27, 16). Accordingly, by its terms, the wage provision of the agreement, beginning with January 1, 1948, had twice "renew[ed] itself from year to year," and the other provisions of the agreement, beginning with July 1, 1944, had seven times "continue[d] in effect . . . from year to year." The instances of actual discrimination against non-members of the union took place between December 1949 and February 1950 (*infra*, pp. 8-10), after these successive renewals of the agreement.

2. *The prevailing system of employment*

Insulation jobs, whether installation or repair, are of short duration, employees working on numerous small jobs lasting but a few days at a time (R. 27; Tr. 119, R. 87). As the work comes up, the contractors call the Union for the requisite number of workers whom the Union dispatches as requested (R. 27; 77, 100). Generally all asbestos workers are dispatched by the Union

upon request from an employer although it is also permissible for the men to locate the job and then to secure clearance from the Union before starting work (R. 27; 106, 80-81). Such clearance, however, is essential before the worker may be employed (R. 27; 102, 93-94, 99, 81, Tr. 110).

For over ten years, the Union has had, and now has, a membership of approximately 41 persons; members of the Union are known as "card men" (R. 27; 77). The Union also permits "travelers"—card men from other locals in the same International Union—to work in the Seattle area (R. 27; 93-94, Tr. 110). A final category of asbestos worker is a "permit man"; a permit man is an individual authorized by the Union to work at his craft but who is not accorded membership in the Union (R. 27; 77). During the war years as many as 350 men were granted permits to work by the Union (R. 27; 111). Since the end of hostilities, as ship construction and repair work dropped off, the number of permit men has correspondingly diminished (R. 27; 109, 110-111). The Union's discrimination in this case was directed at the last of the permit men.

C. The Discrimination In Employment Practised By The Union Against The Non-Members

With the tremendous increase in shipbuilding and ship repair in the Seattle area during the war, the Union, in order to overcome the resulting shortage of insulation workmen, approached other AFL locals in the vicinity seeking volunteers (R. 27-28: 99). From such sources, the Union recruited, among others, six employees named Sidney A. Lennox, Toive E. Eskola,

Uhro A. Kangas, Alfred J. Vollan, Leroy D. Lucy, and Marvin N. Rosand. All were members of other AFL craft unions in the Seattle area, and the Union allowed them to work as asbestos workers under permit (R. 28; 98, Tr. 36-37, 50, 66, 80-81, 90). These men began their insulation work between the years 1940-1943, and have made their livelihood from it ever since, returning to their original craft only when there was no insulation work to be done, a definite minority of the time (R. 28; 88, 86). Throughout their tenure as insulation workers, each worked under permit from the Union, paying all the dues required by the Union either directly to the latter or indirectly to the local to which each belonged (R. 28; 78-79, 83, 89, 98-99, Tr. 90).⁵ None has worked without clearance from the Union and until either September 1949, or February 1950, they were dispatched by the Union's business agent in the same manner as the card men (R. 28; 94, 90, 85, 79-81, 99).

Employee Arthur Lennox performed his last work in the insulation trade in September 1949, at which time he was laid off at the completion of a job (R. 29; 79, 82).

⁵ Three of the men, Lennox, Eskola, and Kangas, made application on one or more occasions between 1947 and 1949 for membership in the Union (R. 28-29; 83, 88-89, 78). Each of these applications was rejected by the Union, which has accepted only two new members in the past year and a half or two years (R. 28-29; 83, 89, 111). Gagner, the Union's business agent, testified that the applications were rejected because the men "were not qualified" (R. 29; 109-110). However, since the applicants were blackballed in a general meeting of the membership, without being referred to the union's examining board which passes upon the work qualification of the various applicants, the Board rejected this explanation (R. 29; 112). The Board concluded that the reason for the rejection was more accurately reflected in the business agent's candid testimony that "we have built up this trade and must maintain it . . . It isn't the employer's trade . . .," and that of late years "the pickings" have been "pretty slim" as the work on the waterfront has run approximately one-half a man per day (R. 29, n. 4; 109).

Sometime in January 1950, he spoke to Ben Bradley, the Company's superintendent, about obtaining work and was told by Bradley that there was a job for him if he could secure clearance from the Union (R. 29-30; 79, 100-102). When Lennox called business agent Gagner, the latter refused to issue him a permit, stating that "he was bringing in men from Portland and Bremerton, and that there was no work for permit men" (R. 30; 79-80). Shortly thereafter, Superintendent Bradley again told employee Lennox about a specific job he could have if the Union would clear him (R. 30; 80, 101). At the request of Lennox, Bradley himself called Business Agent Gagner and asked that Lennox be assigned to this particular job (R. 30; 101-102). Gagner refused, stating that "he wasn't going to put out any more permit men" (*ibid*). In another telephone conversation at this time in which Lennox informed Gagner of work available on a specific ship, the latter again stated that "he wasn't prepared to put permit men to work and [that] he was getting ample men from Portland and Bremerton" (R. 30; 80). Thus, Lennox has been unable to secure employment in the industry in which he had earned his livelihood since 1942 (R. 30; 78, 81).

On December 24, 1949, when employee Marvin Rosand was employed on an insulation job for the Company, the Union's business agent advised Superintendent Bradley that Rosand was to be replaced by a card man (R. 30; 98, 103). Bradley accordingly laid off Rosand and replaced him thereafter with a card man (R. 30; 103). Rosand, having heard that the Union would no longer issue permits, has not since asked for

work in the industry and has never been assigned by the Union to any job (R. 30; 98). He has returned to his former occupation of pile driver (R. 30; 97).

On February 8, 1950, employees Eskola, Kangas, Vollen, and Lucy were all employed by the Company on insulation work which it was installing on the *U. S. S. Freeman*, an Army transport ship (R. 30; 83-84, 89, 92, 95, 102). When the Company decided to reduce its staff on that job, Superintendent Bradley informed business agent Gagner of the impending layoff and inquired how it should be carried out (R. 30-31; 102). Gagner decreed that the permit men be dropped first, and in accordance with these instructions, the following day all the permit men were laid off, even though some of the card men who remained at work had less seniority on the job (R. 31; 102-103, 114-115, 84, 92-93, 96). In effecting the layoff, Superintendent Bradley told employees Kangas, Vollen and Lucy that the Union's business agent had requested that the permit men be laid off (R. 31; 89, 91, 92-93, 96).

Since that date, February 8, 1950, no permit men have been assigned work in the insulation field by the Union, even though such work has been available (R. 31; 90, 110-111). Thus, business agent Gagner has faithfully adhered to the no-permit policy which he had announced to two of the permit men who had requested clearance for jobs (R. 31; 93, 96-97).

II. The Board's Conclusions of Law

The Board found that, in violation of Section 8 (b) (2) and 8 (b) (1) (A) of the Act, the Union had refused to issue work permits to the six named employees and,

pursuant to the illegal closed-shop provision of the agreement, had required the Company to layoff or refuse to hire these six employees because they did not have such work permits (R. 46, 36). Although the closed-shop agreement had been entered into before the amendments to the Act, and was therefore valid at its inception, it had been "renewed or extended" thereafter by operation of the automatic renewal clause of the agreement, and upon such renewal its continuing validity ceased under the express provisions of Section 102 of the Act (R. 46-48, 32-34). The provision in the agreement for the arbitration of differences arising from the request of either party to modify or change it at specified intervals is immaterial to the question whether a renewal or extension of the agreement has been effected (R. 47-48).

III. The Board's Order

The Board ordered the Union to cease and desist from (1) requiring the enforcement of the closed-shop provision of its existing contract with Seattle Construction Council, (2) causing the Council and its members, including the Company, to discriminate in regard to the hire and tenure of employment of persons who are not members of the Union, and (3) restraining or coercing employees in the exercise of their right to refrain from concerted activities (R. 49-50). Affirmatively, the Board ordered the Union to notify the Seattle Construction Council and its members, including the Company, that it no longer considers the union-security provisions of the contract to be in effect or binding upon the parties, and that it withdraws its objections to the em-

ployment of the six named employees (R. 50). The Board also ordered the Union to make whole these employees for any loss of pay caused by the discrimination against them, and to post appropriate notices (R. 50-51).

SUMMARY OF ARGUMENT

By requiring the Company to lay off or refuse to hire the six named employees because of their non-membership in the Union or lack of union clearance, the Union clearly violated Section 8 (b) (2) and 8 (b) (1) (A) of the Act. The closed-shop contract to which the Company and the Union are parties does not justify these discriminatory acts, since, although entered into prior to the enactment of the 1947 amendments to the Act, which proscribe such a contract, the contract was thereafter "renewed or extended" within the meaning of Section 102 to the Act, so that the validity of the contract had ceased before the discrimination occurred. The renewal or extension of the contract resulted from the operation of the contract's clause, which provided that unless notice of a desire to effect a change was given by one of the parties within a prescribed time, the contract was "to continue in effect thereafter from year to year." Since neither party served the other with the prescribed notice subsequent to the enactment of the amendments to the Act, the contract "renewed or extended" itself upon the date provided for therein. That the parties contemplated a renewal becomes evident upon examination of the wage termination provision, which, identical in effect and operation to the general termination clause, speaks explicitly in terms of "*renew(al)* . . . from year to year." (Emphasis

supplied.) The provisions in the agreement for the arbitration of proposed changes upon which the parties are unable to agree is immaterial to the question whether a renewal or extension of the agreement has been effected.

ARGUMENT

In Violation of Section 8 (b) (2) and 8 (b) (1) (A) of the Act, the Union Required the Company to Lay Off or Refuse to Hire Six Named Employees Pursuant to an Invalid Closed-Shop Agreement.

As shown (*supra*, pp. 7-10), the Union refused to issue work permits to the six named employees and, pursuant to the closed-shop provision of the agreement, required the Company to lay off or refuse to hire these individuals because they did not have such permits. Thus, the Union refused to clear employee Lennox for work, even at the request of the Company's superintendent, effected the replacement of employee Rosand with a member of the Union, and caused the layoff of the four other permit men because of their nonmembership in the Union. Added to these incidents of discrimination are the repeated statements of the Union's business agents that no permit men would be put to work, and the Union's faithful adherence to this practice of no clearance for such workers. By its conduct, the Union unquestionably caused the Company to discriminate against employees, in violation of Section 8 (b) (2) of the Act, and restrained and coerced the employees because of their lack of membership in the Union, in violation of Section 8 (b) (1) (A) of the Act,⁶ unless

⁶ E.g., *N.L.R.B. v. Newspaper and Mail Deliverers' Union*, 192 F. 2d 654 (C.A. 2); *N.L.R.B. v. Peerless Quarries, Inc.*, 29 LRRM 2262 (C.A. 10, Dec. 31, 1951); *Union Starch & Refining Co. v.*

at the time the discrimination was practiced the closed-shop agreement continued to retain its validity.

Section 102 of the Act expressly stipulates that the closed shop provision of an agreement entered into before the enactment of the amendments ceases to be valid when the agreement is thereafter "renewed or extended." Its explicit wording is as follows:

. . . the provisions of section 8 (a) (3) and section 8 (b) (2) of the National Labor Relations Act as amended by this title shall not make an unfair labor practice the performance of any obligation under a collective bargaining agreement entered into prior to the date of the enactment of this Act, or (in the case of an agreement for a period of not more than one year) entered into on or after such date of enactment but prior to

N.L.R.B., 186 F. 2d 1008 (C.A. 7), cert. denied, 342 U.S. 815; *N.L.R.B. v. National Maritime Union*, 175 F. 2d 686 (C.A. 2), cert. denied, 338 U.S. 954; *United Mine Workers v. N.L.R.B.* 184 F. 2d 392 (C.A.D.C.), cert. denied, 340 U.S. 934.

Before the Board, the Union urged three factual contentions to exonerate itself from the charge of discrimination, all of which were decided adversely to it by the Board, and the evidence in support of the Board's findings are indisputably substantial considering the whole record. First, the Union urged that it did not insist upon or cause the layoff or refusal to hire the six employees, the Company itself being solely responsible for those acts. The testimony of the Union's business agents, upon which this contention is based, conflicts with the disinterested testimony of superintendent Bradley, the testimony of the six employees, and the overt circumstances (R. 35). Second, the Union urged that when the six employees called the Union's business agents for jobs, there was no work available to which they could be assigned. This again presented a conflict between the testimony of the business agents and that of Bradley and the six individuals, and was also inconsistent with the increase in ship construction and repair (R. 35). Third, the Union urged that the men were not qualified as insulation workers, especially with respect to uptown as contrasted with shipyard work. In view of the fact that these men had been earning their livelihood at such work since the early part of the war, of the high regard in which their work was held by superintendent Bradley, and their known ability to handle all types of insulation work, this contention is without merit.

the effective date of this title, if the performance of such obligations would not have constituted an unfair labor practice under section 8 (3) of the National Labor Relations Act prior to the effective date of this title, *unless such agreement was renewed or extended subsequent thereto.* (Emphasis supplied.)

In this case the Board held that, by operation of the automatic renewal provisions of the agreement, it had been renewed or extended after the amendments and before the acts of discrimination occurred, so that no legal closed-shop agreement was in existence validating the discrimination.

At pages 11 to 21 of the Board's brief before this Court in *N.L.R.B. v. Clara-Val Packing Company*, 191 F. 2d 556, to which the Court is respectfully referred,⁷ the Board identified the elements of an automatic renewal clause and stated the reasons why an agreement running for an additional term by virtue of it was "renewed or extended" within the meaning of Section 102 of the Act. Without repeating the details of the analysis, it suffices to restate that the elements of an automatic renewal clause are (1) a specified period which ordinarily is the only time that changes or modifications of the contract may be negotiated, (2) a specified date by which time notice must be given by either party wishing termination or modification, (3) the signification, by absence of timely notice, that the contract will bind the parties for an additional specified term. Once an agreement runs for an addi-

⁷ A copy of the Board's *Clara-Val* brief has been furnished counsel for the Union.

tional period because of automatic renewal, it has been “renewed or extended,” for Congress intended to defer the invalidity of a closed-shop agreement only for the balance of its unexpired term, and the expiration occurs when the period prescribed by the contract for the negotiation of changes arrives.

In *Clara-Val* this Court evidently agreed that a contract which acquires an additional term by virtue of the operation of an automatic renewal clause has been “renewed or extended” within the meaning of Section 102. This Court held, however, that the agreement in question in *Clara-Val* did not provide for automatic renewal, for the agreement provided that it “shall continue without expiration date until” specified events (191 F. 2d, at 558), and such an agreement “is not terminated on its anniversary where the parties take no action” (191 F. 2d, at 559). This Court distinguished this form of agreement from a true automatic renewal in the following manner (191 F. 2d, at 558):

In the Matter of Mill B., 40 NLRB 346, 348, the contract provided “this agreement is for one year.” In the Matter of Green Bay Drop Forge Co., 57 NLRB 1417, 1419, the contract provided that it “shall remain in effect for one year and for renewal periods of one year thereafter” (emphasis supplied). Similarly in United States Pipe and Manufacturing Co., 78 NLRB 15, 16. In Grove-ton Papers Co., 52 NLRB 1256, 1257, the contract was expressly made a “year to year” contract. In each of the following cases the contract was for a specific period of a year and for “year to year” thereafter: Borg-Warner Corp., 58 NLRB 449, 450; Narranganset Electric Co., 64 NLRB 1492, 1493; Neon Products, Inc., 74 NLRB 766, 767;

Manhattan Coil Corp., 79 NLRB 187, 189; North Range Mining Co., 47 NLRB 1306, 1307; Little Rock Mfg. Co., 80 NLRB 65.

In *Patrick Cudahy Family Co. v. Bowles*, 138 F. 2d 574, 575 (Cir. 1) the contract expressly provided for a *renewal*. It was for a definite two year period, to be renewed on identical terms for a like successive period.

The agreement in this case falls squarely within the pattern of agreements distinguished in *Clara-Val*.

Thus, the clause of the agreement governing the duration of all employment conditions except wages provided that, after it took "effect on July 1, 1943," it was to last "*from year to year*," subject to notice of a desire to negotiate changes which may be given ninety days prior to each anniversary date (*supra*, p. 5). Accordingly, the language "year to year" which this Court regarded as pivotal in *Clara-Val* appears in this agreement. Any doubt is dispelled by reference to the clause governing the duration of the wage provision. It stipulated that the wage provision "shall remain in effect until January 1, 1948 unless notice is given 90 days prior to July 1, 1947 and shall *renew itself from year to year thereafter*" (*supra*, p. 5). The wage duration is thus explicitly couched in the language of renewal, a factor which this Court emphasized in *Clara-Val*. In the present agreement, the only significant difference between the clauses governing the duration of wages and other employment conditions is that the initial period during which the wage provision may not be changed is longer than that pertaining to the other terms of employment. Of course, this

distinction is immaterial to the character of the renewal which prevails after the initial period expires.

It is clear, therefore, that the agreement in this case contains a true provision for automatic renewal as this Court conceived it in *Clara-Val*. The amendments to the Act became effective on August 22, 1947; thereafter, the wage provision of the agreement was automatically renewed on January 1, 1948, and the other provisions were automatically renewed on July 1, 1948; and the acts of discrimination occurred between December 1949 and February 1950. Accordingly the unfair labor practices took place at a time when the closed-shop agreement no longer validated their commission.

Before the Board, the Union contended that a renewal or extension of the agreement was precluded by the provision in the agreement for the final and binding arbitration of any requested changes on which the parties were unable to agree, the Union's theory evidently being that the agreement was thereby perpetual in form on the ground that no break in contractual relations could occur.⁸ The fallacies in this contention are manifold. First, the contractual availability of arbitration does not obliterate the fact that the closed-shop provision of the agreement existed "from year to year." At a specified interval each year, it is subject to change upon the giving of timely notice, and it is the failure to give this notice, not the availability of arbitration, which prolongs the life of the

⁸ The Board held in accordance with the Union's contention that all provisions of the agreement were subject to settlement by arbitration (R. 46-47). The examiner, however, had held that wage disagreements were not arbitrable under the contract, and therefore the Union's contention failed because "an essential feature of this contract would expire in the event of an unsettled dispute over changes therein" (R. 34).

closed-shop provision for at least another year. Second, accord reached by arbitration effects a renewal or extension of an agreement in no different sense than accord reached by direct negotiation. It does not mean that a renewal or extension has not been made merely because an assured means of bringing it about has been provided. Third, it is not true that the availability of arbitration prevents a break in contractual relationships. The time consumed by arbitration may extend beyond the anniversary date of the agreement, and in the absence of an interim agreement, a break in contractual relations may eventuate. Fourth, since under the arbitral scheme the selection of the third umpire by the U. S. Department of Conciliation is subject to the approval of both parties (*supra*, p. 6), a failure to agree on this subject may prevent arbitration at the threshold, so that on this additional ground a break in contractual relations may in fact take place.

In short, the means by which an agreement acquires an additional term, whether by automatic renewal, direct negotiation, settlement by mediation, or decision by arbitration, is immaterial to whether a renewal or extension of the agreement has been effected within the meaning of Section 102 of the Act. In this case, the agreement having been renewed or extended by automatic renewal, the Board properly found that its closed-shop provision no longer validated the discrimination practiced.⁹

⁹ Before the Board, the Union contended that because charges of discrimination were filed by employees Lennox, Eskola, Kangas and Rosand, but not by employees Lucy and Vollan, the Board erroneously received evidence pertaining to the discrimination practiced against employees Lucy and Vollan. It is settled that the charges of discrimination filed by the four employees suffices to support the complaint and ensuing prosecution pertaining to all

CONCLUSION

For the reasons stated it is respectfully submitted that a decree should issue enforcing the Board's order in full.¹⁰

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six. *N.L.R.B. v. Globe Wireless, Ltd.*, 29 LRRM 2319, 2321-2322 (C.A. 9, December 27, 1951); *Kansas Milling Co. v. N.L.R.B.*, 185 F. 2d 413, 415-416 (C.A. 10); *N.L.R.B. v. Westex Boot & Shoe Co.*, 190 F. 2d 12, 13 (C.A. 5); *N.L.R.B. v. Kingston Cake*, 191 F. 2d 563, 567 (C.A. 3); *Cusano v. N.L.R.B.* 190 F. 2d 898, 903-904 (C.A. 3); *N.L.R.B. v. Bradley Washfountain Co.*, 192 F. 2d 144, 149 (C.A. 7).

¹⁰ A week after the Board's decision issued, the Union petitioned the Board to reconsider and to re-open the record, alleging that after October 18, 1950 it abandoned the permit system and had so notified all employers, including the Company (R. 54-56). It argued that these additional facts rendered moot several items of affirmative action required by the Board and made necessary an amendment to the rule for computing the loss of pay. Such alleged facts, indicative of partial compliance, could not render the Board's order moot (*N.L.R.B. v. Mexia Textile Mills*, 339 U.S. 563; *N.L.R.B. v. Pool Mfg. Co.*, 339 U.S. 577; and insofar as back pay is concerned, the Board's decision as it now stands explicitly states the conditions to be met in order for the Union to toll its liability for back pay (R. 48). Whether the action the Union alleges it has taken meets those conditions should be resolved, assuming amicable efforts at adjustment fail, in compliance proceedings after the entry of an enforcement decree. *N.L.R.B. v. Bird Machine Co.*, 174 F. 2d 404 (C.A. 1); *Wallace Corp. v. N.L.R.B.*, 159 F. 2d 952 (C.A. 4); *N.L.R.B. v. New York Merchandise Co.*, 134 F. 2d 949 (C.A. 2). Accordingly, the Board's denial of the Union's motion (R. 56-57) was proper.

APPENDIX

The relevant provisions of the National Labor Relations Act, as amended (61 Stat. 136, 29 U.S.C. Supp. IV, Secs. 151, *et seq.*), are as follows:

RIGHTS OF EMPLOYEES

Sec. 7. Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8 (a) (3).

UNFAIR LABOR PRACTICES

Sec. 8. (a) It shall be an unfair labor practice for an employer—

* * * * *

(3) By discrimination in regard to hire or tenure of employment or any term or condition of employment to encourage or discourage membership in any labor organization: *Provided*, That nothing in this Act, or in any other statute of the United States, shall preclude an employer from making an agreement with a labor organization (not established, maintained, or assisted by any action defined in Section 8 (a) of this Act as an unfair labor practice) to require as a condition of employment membership therein on or after the thirtieth day following the beginning of such employment or the effective date of such

agreement, whichever is the later, (i) if such labor organization is the representative of the employees as provided in Section 9 (a), in the appropriate collective-bargaining unit covered by such agreement when made; and (ii) if, following the most recent election held as provided in Section 9 (e) the Board shall have certified that at least a majority of the employees eligible to vote in such election have voted to authorize such labor organization to make such an agreement: *Provided further*, That no employer shall justify any discrimination against an employee for nonmembership in a labor organization (A) if he has reasonable grounds for believing that such membership was not available to the employee on the same terms and conditions generally applicable to other members, or (B) if he has reasonable grounds for believing that membership was denied or terminated for reasons other than the failure of the employee to tender the periodic dues and initiation fees uniformly required as a condition of acquiring or retaining membership;

* * * * *

(b) It shall be an unfair labor practice for a labor organization or its agents—

* * * * *

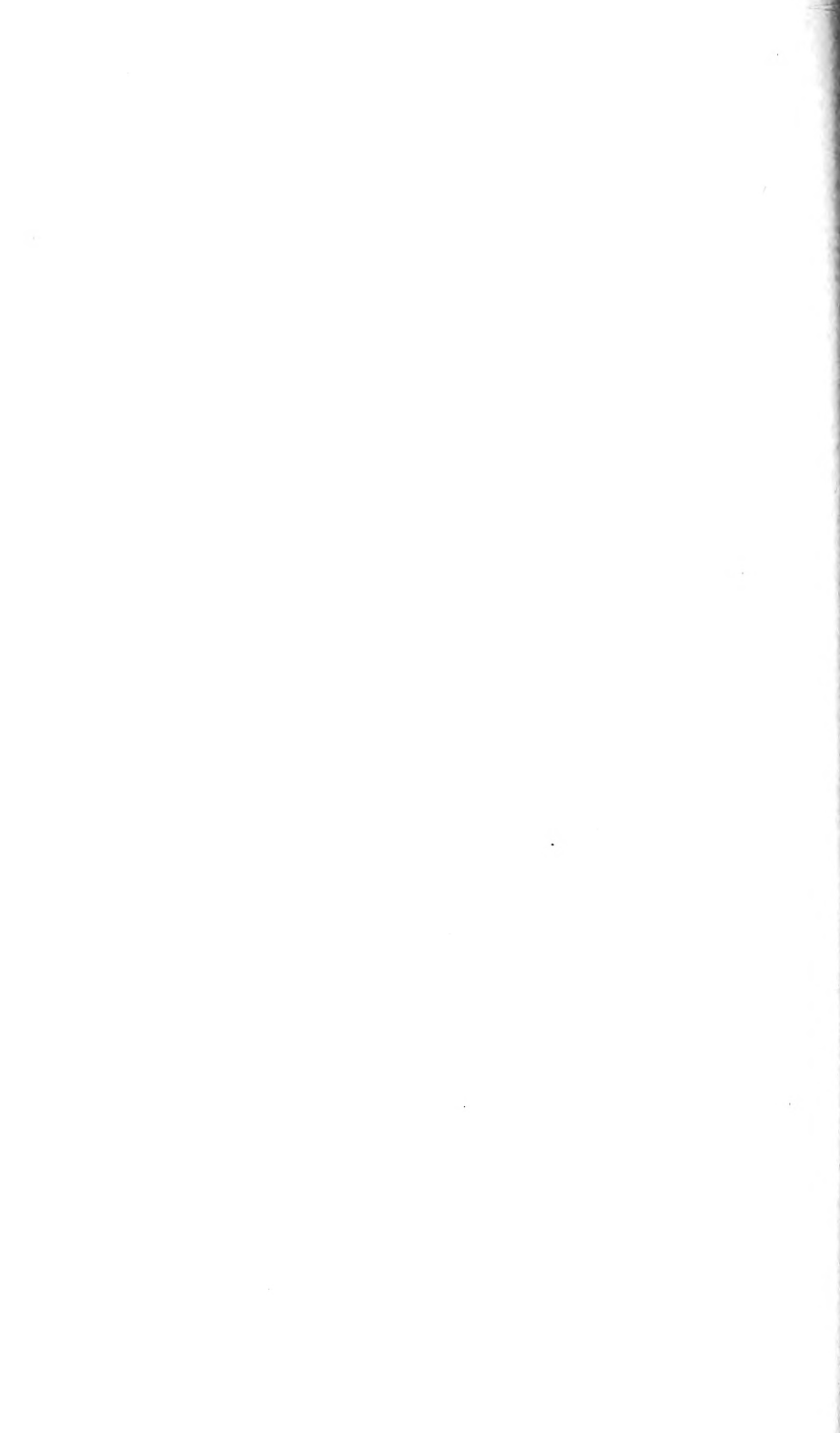
(1) To restrain or coerce (A) employees in the exercise of the rights guaranteed in Section 7;

(2) To cause or attempt to cause an employer to discriminate against an employee in violation of subsection (a) (3) or to discriminate against an employee with respect to whom membership

in such organization has been denied or terminated on some ground other than his failure to tender the periodic dues and the initiation fees uniformly required as a condition of acquiring or retaining membership;

* * * * *

SEC. 102. No provision of this title shall be deemed to make an unfair labor practice any act which was performed prior to the date of the enactment of this Act which did not constitute an unfair labor practice prior thereto, and the provisions of section 8 (a) (3) and section 8 (b) (2) of the National Labor Relations Act as amended by this title shall not make an unfair labor practice the performance of any obligation under a collective-bargaining agreement entered into prior to the date of the enactment of this Act, or (in the case of an agreement for a period of not more than one year) entered into on or after such date of enactment, but prior to the effective date of this title, if the performance of such obligation would not have constituted an unfair labor practice under section 8 (3) of the National Labor Relations Act prior to the effective date of this title, unless such agreement was renewed or extended subsequent thereto.



No. 13,139

IN THE

**United States Court of Appeals
For the Ninth Circuit**

NATIONAL LABOR RELATIONS BOARD,
Petitioner,

VS.

INTERNATIONAL ASSOCIATION OF HEAT
AND FROST INSULATORS AND ASBESTOS
WORKERS, LOCAL NO. 7, AFL,
Respondent.

On Petition for Enforcement of an Order of the
National Labor Relations Board.

BRIEF FOR RESPONDENT

**INTERNATIONAL ASSOCIATION OF HEAT AND FROST
INSULATORS AND ASBESTOS WORKERS,
LOCAL NO. 7, AFL.**

FILED

MAR 13 1952

L. PRESLEY GILL,
2800 First Avenue, Seattle, Washington,
Attorney for Respondent.

**PAUL P. O'BRIEN
CLERK**



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BRIEF FOR RESPONDENT

**INTERNATIONAL ASSOCIATION OF HEAT AND FROST
INSULATORS AND ASBESTOS WORKERS,
LOCAL NO. 7, AFL.**

SUPPLEMENTAL STATEMENT OF THE CASE.

A. THE CHARGE OF UNFAIR LABOR PRACTICES.

1. Charge by Uhro A. Kangas.

Kangas filed a charge alleging the commission of unfair labor practices against himself, Alfred J. Vollan and LeRoy D. Lucy in these words:

“The above named labor organization, by its officers, agents and employees, has caused the Charles R. Brower Co. to terminate the employment and/or refuse further employment to the following persons in violation of Section 8(a)(3) of the Act: Uhro A. Kangas, Alfred J. Vollan and LeRoy D. Lucy.”

This charge is set out in full in the printed record beginning at page 3, and the above quoted allegation is on page 4. It was admitted in evidence as General Counsel's Exhibit 1-E.

The Charge was not included in the subject matter of the Consolidated Complaint. It was omitted from the title and from the preamble of the Consolidated Complaint. (R 10, 11.)

At the hearing before the Trial Examiner Wilson, the General Counsel moved to amend the title of the case and amend the preamble of the Consolidated Complaint by inserting the name of Uhro A. Kangas, over the objection of the Respondent. (See note and printed Record page 20.)

2. Absence of Charges by Alfred Vollan and LeRoy Lucy.

There were no charges filed by Alfred Vollan or LeRoy Lucy. Although they were alleged to have been subjected to discrimination in the Charge of Kangas, yet they were not included in the Consolidated Complaint in the title or in the preamble. (R 10 and 11.) The General Counsel moved to amend the title and the preamble to include the name of Kangas and the

amendment was allowed over the Respondent's objection. (R 20, Notes ¹ and ².)

The General Counsel never moved to include the names of Alfred Vollan or LeRoy Lucy in the title or the preamble, nor was there any notice to the Respondents at any time that Vollan or Lucy were to be the subjects of a request for re-instatement, back wages, or any other form of relief or remedy.

Although Vollan and Lucy were called as witnesses by the General Counsel, there was no notice to Respondents that they were called as witnesses on their own behalf or that other witnesses were testifying in support of any unfair labor practice against them.

Respondent supposed that Vollan and Lucy were testifying in support of the other four (4) charging individuals and objected. This subject is discussed thoroughly below in paragraph II "Improper Inclusion of Vollan and Lucy".

The Board in its Decision and Order has directed the Respondent to withdraw objection to the employment of Vollan and Lucy and to pay them back wages as follows (R. 50):

"2. Take the following affirmative action which the Board finds will effectuate the policies of the act:

(b) Notify Seattle Construction Council and its member, including Chas. R. Brower & Co., in writing, and furnish copies of said notice to the individuals involved, that it withdraws its objections to the employment of Sidney A. Lennox,

Toive E. Eskola, Uhro A. Kangas, Alfred Vollan, LeRoy Lucy, and Marvin N. Rosand, and that it has no objection to the employment of said individuals.

(c) Make whole the said Sidney A. Lennox, Toive E. Eskola, Uhro A. Kangas, Alfred Vollan, LeRoy Lucy, and Marvin N. Rosand, for any loss of pay that each may have suffered by reason of the Respondent's discrimination against him, in the manner provided herein and in the section of the Intermediate Report entitled 'The Remedy'."

B. THE CONTRACT CONTINUED IN EFFECT.

The Labor Agreement originally executed on June 30, 1943, was never opened up for negotiations. Elton Hickok was the Manager of the Seattle Chapter of the Associated General Contractors and the Seattle Construction Council, the latter being the employer signatory to the Agreement. He handled negotiations. (R 65.)

The pertinent provisions of the Agreement are (R 66 to 71):

"General Counsel's Exhibit No. 2 Agreement

"1. This Agreement, made in duplicate this 30th day of June, 1943, by Seattle Construction Council, acting collectively and severally for all of its members, employers of craftsmen and labor, Party of the First Part, and Seattle, Washington, Building and Construction Trades Council,

Party of the Second Part, acting collectively and severally for all their members.

* * * * *

“4. To determine the wage scales for the Building Trades from January 1, 1944, and each calendar year thereafter to and including January 1, 1947, it is hereby agreed that we follow the following plan:”

(Here follows a complicated method of applying the changes in the Cost of Living Index to increase or decrease the wage scales, and the effective dates thereof.)

“Paragraph 4 of this contract shall remain in effect until January 1, 1948, unless notice is given (testimony of Elton Hickok) 90 days prior to July 1, 1947, and shall renew itself from year to year thereafter, provided that wages shall be adjusted from time to time as provided for in Paragraph 4.

“All other conditions of this Agreement shall take effect on July 1, 1943, and continue in effect thereafter from year to year until changed by the mutual agreement of the parties as provided herein. *Proposed changes or modification of this Agreement shall be made by either party giving notice thereof in writing to the other party at least 90 days before July 1, and such notice shall specify the provisions desired to be changed and shall state the time and place at which negotiations may commence. The other party shall enter into negotiations not later than 30 days from the date of the receipt of said notice, after party has notified the other in writing of proposed modifications*

and changes in Agreement. *In the event no accord can be reached in the succeeding 60 days, arbitration as provided hereinafter shall be resorted to.*

“5. It is mutually agreed by the parties hereto that an Adjustment Board shall be established consisting of six (6) members to be selected by the party of the first part, and six (6) members to be selected by the party of the second part, and an equal vote to be had on all questions, three (3) from each side consisting a quorum.

“5 (a) Said Adjustment Board shall meet within forty-eight (48) hours on written request by either party to this Agreement.

“6. It Is Further Agreed by both parties hereto that all disputes and grievances that cannot be speedily and amicably adjusted on the work shall be submitted to the accredited agents of the parties hereto, and if not adjusted by them shall be submitted to the Adjustment Board, whose decision shall be submitted in writing and be final and binding upon both parties. Pending such decision there shall be no strike or lockout, except that where non-Union men are employed the Party of the Second Part reserves the right to remove all Union men from the job. In the event the Adjustment Board shall be unable to reach an Agreement, the U. S. Department of Conciliation shall be given the opportunity to adjust the difficulty in a manner acceptable to both parties signatory hereto. If such adjustment cannot be reached both parties and the U. S. Department of Conciliation shall each appoint an umpire and their decision shall be final and binding upon both parties. The Umpire appointed by the U. S. Department of

Conciliation to be satisfactory to both parties hereto.”

* * * * *

“8. Wage Scale: It is further agreed that the following wage scale is accepted and approved by both parties and shall continue during the life of this Agreement unless changed under the provisions of Section 4. The classifications of employment and the wage scales applying thereto shall be in accordance with Schedule ‘A’, attached hereto. Additions for the purpose of clarification or supplying omissions may be made from time to time by agreement between the interested parties hereto.”

While the Escalator Clause functioned automatically, a re-drafting of the clause could be effected by the giving of a 90-day notice prior to July 1st of any year.

However, a proposed change in this clause would be negotiated and if no accord could be reached on the proposed changes, the dispute would be arbitrated. (See last sentence of Paragraph 4 above.)

The Trial Examiner in his Intermediate Report decided that the arbitration clause did not apply to a re-opening of the Escalator Clause in Paragraph 4.

Intermediate Report, Conclusions (R 34):

“However, the Respondent argues that the cases cited for the proposition above are inapplicable here for the reason that this contract provides for arbitration in the event that the parties to the contract should be unable to agree upon the requested changes in conditions of employment after

60 days of negotiations, that this arbitration decision is final and binding on both parties and, therefore, the contract here is made perpetual by reasons of its arbitration features, while in the cases above cited there were no similar arbitration features and thus automatically ceased to exist at the end of the anniversary period in the event of an unsettled state of negotiations. Unfortunately for the Respondent's contention here there is no such arbitration feature connected with the escalator wage scale provisions of the present contract, although changes could be demanded therein by notice given 90 days prior to the date of July 1. Thus, an essential feature of this contract would expire in the event of an unsettled dispute over changes therein."

However, the Board in its Decision and Order disagreed (R 46) :

"The Respondent contended that the contract, entered into before the effective date of the 1947 amendments, was not renewed thereafter and that the validity of the contract was thus preserved by Section 102 of the Act. In making this contention, the Respondent urges that certain so-called arbitration provisions of the contract make it one of perpetual duration and thus this case is distinguishable from others in which the Board has held that a contract was renewed within the meaning of Section 102. In rejecting this contention, the Trial Examiner construed the contract so as to make the so-called arbitration provisions inapplicable to Paragraph 4 of the contract which provides that its wage provisions 'shall remain in effect until January 1, 1948, unless notice is given 90 days

prior to July 1, 1947, and shall renew itself from year to year thereafter * * *. We do not so construe the contract.”

Hickok, Manager of the Employer, signatory to the Agreement testified that neither the escalator clause (paragraph 4 of General Counsel’s Exhibit No. 2) nor any other provision of the Agreement was opened up for negotiations at any time. This testimony does not appear in the printed record and is set forth below (Tr. 25, line 18) :

“Q. And since you have been Manager have you participated in any negotiations with labor unions?

A. We have—due to the type of contract we have, it hasn’t been necessary for any labor negotiations.”

ARGUMENT.

I.

IMPROPER INCLUSION OF KANGAS, VOLLAN AND LUCY.

Uhro A. Kangas filed a charge against the Respondent. His name was omitted from the title of the Consolidated Complaint and omitted from the preamble of the Consolidated Complaint.

When charges are filed, it is customary for the Regional Director with whom they are filed to immediately send a copy to the person or organization which is alleged therein as having committed the alleged unfair labor practices. It is also customary for the Regional Director to request an answer to the charges.

The Regional Director (or the General Counsel of the Board) makes an investigation and if there is merit in the charges the Regional Director issues a complaint. To the complaint is attached a copy of the charge on which the complaint is issued. The Respondent can assume with respect to any charges which are not included in the complaint, that the charges have been found to be without merit.

The Charge of Kangas was filed as 19-CB-97. It was not attached to the Consolidated Complaint, nor was his name listed in the title or in the preamble.

When the hearing was opened before Trial Examiner Wilson, the General Counsel included the Charge of Kangas, 19-CB-97, as part of the Board's file and it was marked and received in evidence as Board's Exhibit 1-g. The Affidavit of Service of the Charge is Board's Exhibit 1-h. (Transcript 6.)

The General Counsel moved to amend the title and the preamble of the Complaint. The printed record does not set forth the motion or the objection. Since Respondent's additions to the printed record are few, it is convenient to except the testimony here. The General Counsel moved to amend (Transcript 8):

“Mr. Tillman. In connection with the original Charge in 19-CB-97, which I mentioned was inadvertently not attached to the Complaint, it was also not—I might say the Complaint also was not in conformity with the original Charge insofar as the caption fails to set forth the name of the charging party. Therefore, I would move to amend the caption of the case, on the lines where appears

the name, Marvin N. Rosand, by adding before that name the words, 'Uhro A. Kangas,' and making it read then on that line, 'Uhro A. Kangas and Marvin N. Rosand.'

Then, I also move to substitute for the words on that same line, 'an individual' the word, 'individuals'."

To which Respondent objected (Transcript 9):

"Mr. Gill. We object to the motion to amend. We have in mind the title lists three persons as to whom—allegedly their rights had been impaired. In the Complaint, in addition to those, there are three other individuals listed, one of whom is this Mr. Kangas, and I move to strike the reference to those three other persons. I think it is untimely at this time to start off with the Complaint based on alleged discriminations against three people, and then go and add a fourth. There is a possibility of adding two more if counsel's theory is correct, and I think it is prejudicial to our rights."

The Respondent repeated its objection and inquired whether the General Counsel had any plan to adding, in addition to Kangas, the other persons mentioned in the Kangas Charge, Vollan and Lucy. The General Counsel stated that he only wanted to add Kangas and not Vollan or Lucy (Transcript p. 10):

"Mr. Gill. I am certain it is a surprise. We came here prepared for the three individuals listed in the caption as the ones discriminated against, and now a fourth has been added, and if their theory is correct, we will be confronted with two more.

Trial Examiner Wilson. You have read the complaint?

Mr. Gill. Yes, we read the Complaint, and this portion on Mr. Kangas is immaterial. The fact that Mr. Kangas has been discriminated against is no proof we discriminated against Vollan and Rosand (Lucy), and I have a Motion to Strike that complaint. Counsel hasn't explained yet why he wanted one added, Mr. Kangas, and still omits the two others.

Mr. Tillman. I have explained it in this sense—the original Charge in 97 was filed by one man, but he named himself and two or three others as the discriminatees. Therefore, to make the formal papers read accurately, I should like his name included as one of the charging parties.”

At Transcript page 11:

“Trial Examiner Wilson. And you contend you are surprised, Mr. Gill?

Mr. Gill. Surprised on this basis. We have a Motion to Strike the three, and it is basically sound, legally, that any proof of discrimination against Kangas would not be proof of discrimination on the issues of the case as to Vollan and Rosand (Lucy), and the Charge I have here next to our copy, the service copy for Rosand, doesn't mention Kangas in any way in the Charge. We have had no notice of the Charge as to proceeding to a hearing on Kangas except just a moment ago.

Trial Examiner Wilson. You mean to tell me you are not prepared to go ahead and defend the case against Kangas?

Mr. Gill. If you will grant a recess—if that is the basis of your line of thinking—I will inquire

of my people. If it is possible that I can have a short recess and make inquiry. I want to be fair about it on that issue.

Trial Examiner Wilson. Well, Mr. Gill, as the names are all mentioned here in various and sundry paragraphs, including paragraph 16, I am not quite prepared to see how you have been taken by surprise. I will deny this motion, Mr. Gill. Do you want to be heard on your motion to strike and your motion to dismiss?"

The Trial Examiner did not allow the Respondent a recess to consider whether we were prepared to defend against Kangas, and allowed the motion to include Kangas.

Later Respondent moved to strike the testimony of Kangas (Transcript 79):

"Mr. Gill. Mr. Trial Examiner, in order to preserve my rights, I move to strike all of the testimony of the last preceding witness, Mr. Kangas, on the ground that he was not included in the title of the case as one of the persons who had allegedly been discriminated against.

Trial Examiner Wilson. I will deny that and allow the testimony to stand. I want to preserve my record, Mr. Gill."

Vollan was called as a witness by the General Counsel. (Transcript page 79.) Respondent mistakenly thought the witness was Rosand and when apprised that his name was Vollan, the Respondent moved to strike his testimony (Tr. 83):

"Q. (by Mr. Gill). Your first job was a shipyard job, was it, Mr. Rosand?"

A. It isn't Rosand, it is Vollan.

Q. Pardon?

A. It isn't Rosand. It is Vollan.

Mr. Tillman. V-O-L-L-A-N.

Mr. Gill. I am sorry. I move to strike all of this witness' testimony.

Trial Examiner Wilson. Same ruling on that, Mr. Gill.

Mr. Gill. And on the additional ground that any discrimination against Vollan is not proof that the other persons were discriminated against.

Trial Examiner Wilson. Well, Vollan is one of the three in this case, isn't he?

Mr. Gill. No, he isn't.

Trial Examiner Wilson. You mean he is not—he is just not mentioned in the title?

Mr. Gill. Yes.

Trial Examiner Wilson. He is mentioned in the body of the complaint?

Mr. Gill. Yes.

Trial Examiner Wilson. I will over-rule the motion—deny the motion."

It was then obvious that Vollan and Lucy were not being called as witnesses in their own behalf, but as witnesses in support of the four (4) charging individuals. Respondent objected to the testimony of Lucy (Transcript 89):

"Mr. Gill. I move to have this witness excused on the basis that he is not named in the title of the case as being a party, and that any evidence that this witness may offer as to any alleged discrimination affecting him is not any proof that other persons were discriminated against.

Trial Examiner Wilson. Denied."

The objection to Vollan was repeated (Transcript 93):

Cross-Examination.

“Mr. Gill. In this cross-examination I am not waiving the motion——

Trial Examiner Wilson. No, you are not.

Mr. Gill. ——to excuse the witness. It is now a motion to strike his testimony.”

The motions were renewed at the close of the hearing (Transcript 162):

“Mr. Tillman. I am resting. I would like to make my usual motions to conform the pleadings to the proof as to such matters as names, dates, places, and other minor details.

Trial Examiner Wilson. You are not attempting to change your cause of action?

Mr. Tillman. No.

Trial Examiner Wilson. Merely typographical errors and minor discrepancies.

Mr. Gill. If it over-rules any of my objections I object and I don't want his pleadings amended to correct the defect.

Trial Examiner Wilson. They won't be amended in any such way as that, Mr. Gill. Mr. Gill apparently has rested. Everybody seems to be satisfied.

In due course, the Trial Examiner will prepare and file with the Board his Intermediate Report and recommended order in this proceeding, and will cause a copy thereof to be served upon each of the parties.

By the way, did you want to renew your motions, too, I suppose, Mr. Gill?

Mr. Gill. Yes.”

This case was tried on the basis that Kangas was made a party, over Respondent's objections and that Vollan and Lucy were not parties.

Nevertheless the Trial Examiner Wilson included Vollan and Lucy as parties and recommended for them the same relief as was given to the four (4) charging individuals. Discrimination was found to exist as to all six. (R 36.) The proposed Remedy included a cease and desist and back wages (R 37, 38) for all six (6). The Recommendation provided in "(b)" for no objection to the employment of the six. (R 40.) Payment of Back wages was Recommended. (R 40.) Provision for posting of the Notice was required and it enumerated the six persons. (R 43.)

The Board adopted the proposed Remedy and Recommendation of the Trial Examiner and ordered the payment of back wages for all six persons (R 48), and cease and desist for all six. (R 50.)

The Respondent asserts error in the inclusion of Kangas, Vollan and Lucy as violating the Due Process Clause of Fifth Amendment of the Constitution of the United States.

II.

THE CONTRACT CONTINUED IN EFFECT.

Respondent asserts that the contract was not renewed nor extended within the meaning of Section 102, but that it continued in effect. Hickok, the principal officer of the employer-association, testified that no provision of the contract has been opened for negotia-

tion. This appears from the printed Record and is set out by Respondent in the Supplemental Statement of the Cases, Item "B".

The Consolidated Complaint, paragraph XI (R 14) alleged that the contract (R 14; General Counsel's Exhibit 1-L) "has been renewed from year to year both before and after the effective date of the Act * * *"

This was denied in Respondent's Answer Paragraph III. (R 18.)

The Trial Examiner found that the parties had taken no affirmative action to open the contract, but that the parties had by remaining silent, mute and inactive permitted the contract to be renewed and extended with the same effect as if they had affirmatively re-opened it, thereafter re-negotiated it, and concluded with re-execution. (R 34.)

Respondent anticipated this ruling and the cases that it would be based upon, and sought to distinguish the facts by asserting the arbitration clause "In the event no accord can be reached in the succeeding 60 days, arbitration as provided hereafter shall be resorted to" (R 69; General Counsel's Exhibit No. 2, last sentence of paragraph 4), distinguished the facts. We contended that the arbitration clause referred to disputes relative to a re-opening of the Wage Escalator Clause (paragraph 4) as well as to disputes arising from re-opening other provisions of the Agreement.

The Trial Examiner ruled that the arbitration clause did not apply to a re-opening of the Wage Escalator Clause.

Our position was that previous Board decisions were distinguishable on the basis that in those cases on a re-opening of the contract, either party could prevent the renewal of the contract and prevent the extension of a new contract, while in the instant case, although either party could re-open the contract, any dispute would be resolved in arbitration. Therefore, we concluded that contractual relations would continue *ad infinitum* and neither party could prevent a renewal or extension of the contract. We, therefore, felt the contract was within Section 102 of the Act.

The Board reversed the Trial Examiner and held that the arbitration clause was applicable to all provisions of the contract, but the Board reached the same result by holding that the contract was renewed and extended because the arbitration clause was immaterial. (R 47.) Petitioner's Brief concedes this (footnote p. 18):

“The Board held in accordance with the Union's contention that all provisions of the agreement were subject to settlement by arbitration. (R. 46, 47.)”

We have set out in our Supplemental Statement excerpts from the Intermediate Report, the Board's decisions and the Contract.

We consider this court's decision in the case of *NLRB v. Clara-Val Packing Co.*, 191 F. (2d) 556, C.C.A. 9, decided August 30, 1951, to be decisive of the issue that the contract herein involved was the type of contract that Congress intended to exclude in Section 102 of the amended Act.

In that case, the Union learned that its member Stiers after performing work at the Clara-Val plant of the Respondent-employer went to the plant of Driscoll Strawberries, Inc. and performed work. The Driscoll plant was being picketed by the Respondent-union, and the union demanded the discharge of Stiers at the Clara-Val plant. She was discharged under the union security provision of the contract between the Respondents.

Pursuant to Charges, the NLRB ordered her reinstatement, and petitioned this court for an order of enforcement.

The duration clause provided (page 558):

“Section XV Term of Agreement.

(a) The exclusive collective bargaining relationship provided by this Agreement and effective from and after March 1, 1947, shall *continue* expiration date until:

1. Terminated by written notice served by either party upon the other as provided in Paragraph (a) Section XII or in Paragraph (b) of this section, or

2. Terminated by written notice served by either party upon the other as provided in Section XVI (b) 2.

(b) The anniversary date of this Agreement shall be March 1st of each year. If either party desires to terminate the exclusive collective bargaining relationship and this Agreement on any anniversary date, written notice to such effect shall be served between February 16th and March 1st of the year then current.

Section XVI, Procedure for Modification.

(a) In the event either party desires to modify any of the terms of this Agreement or to establish new or different terms or conditions, written notice specifying in exact language the changes desired shall be served within the sixteen (16) day period December 16th to December 31st inclusive. The months of January and February following service of the above notice shall be devoted to negotiations and if the parties are in complete agreement all changes mutually agreed upon shall become effective on March 1st and *shall remain effective for not less than twelve (12) months thereafter.*

(b) If any of the matters under negotiation are still in dispute on March 1st, either of the following actions may be taken:

1. The parties may mutually agree upon an additional period or periods of negotiation and the changes finally agreed upon shall become effective on a mutually acceptable date and *shall remain effective until at least the following March 1st.*

2. Either party by written notice on or *after March 1st may terminate* the collective bargaining relationship and this Agreement.

(c) If during the December 16th to December 31st period, neither party serves notice of a desire to modify any of the terms of this Agreement or to establish new or different terms or conditions, then this Agreement *shall continue* for an additional period of *at least twelve (12) months after the next March 1st anniversary date.*”

The emphasis was supplied by the court.

This court considered the legislative history of Section 102 of the amended Act and held that the House Bill 3020 contained similar language except the last clause "*unless such agreement was renewed or extended subsequent thereto.*" (Emphasis supplied.)

Then the court stated on page 558:

"It was in the conference committee of the two houses that Section 102 attained its present form. Obviously, the extended language of that section as adopted contemplated that the relationship between the parties here was not to be disturbed any more than if the instant agreement had been for a definite term of five years."

This court concluded (page 559):

"(2) An agreement which 'shall continue without expiration date' until terminated or modified by the act of the parties within a fixed period from its anniversary date is not terminated on its anniversary where the parties take no action. It continues. It is not renewed. Where no such action is taken the agreement necessarily must 'continue for an additional period of at least twelve months after the next March 1st anniversary date.' "

In the instant case, the facts of contractual perpetuity are much stronger. In the *Clara-Val* case, the contract specifically provided that neither party could terminate the contractual relationship if the parties pursuant to a re-opening of the contract were not able to agree on a new agreement. Here, the contractual relationship must continue because of the

provision for compulsory arbitration of the provisions of the new agreement.

ANSWER TO PETITIONER'S BRIEF.

The Petitioner's Brief makes no mention of the issue over the inclusion of Vollan and Lucy except in a footnote on page 19. The cases therein listed support the doctrine that one person may prefer and file a charge for himself and other persons. However, these cases hold that notice of the inclusion of such other persons must be given to the Respondent. Here the Board has failed because at no time was the Respondent advised that it was *accused* of discriminating against Vollan and Lucy. We were entitled to a *Notice* and a *hearing*. We have had no *notice* and the *hearing* was not conducted on the basis that Vollan and Lucy were *charging individuals* as to whom Respondent must defend itself.

The record is excerpted in our Supplemental Statement.

Without admitting that the inclusion of Vollan and Lucy was vague and uncertain, yet assuming this in favor of the General Counsel, the case of Vollan and Lucy must fail. A vague statute would be stricken down under the due Process Clause of the Fifth Amendment.

Neither criminal nor civil penalties may constitutionally be imposed under a statute which does not define an offense with sufficient certainty to apprise the persons subject to it of the acts which they are

forbidden to perform. (*International Harvester Co. v. Kentucky* (1914), 234 U. S. 216, 223; *Small Co. v. Am. Sugar Ref. Co.* (1925), 267 U.S. 233, 239; *Cline v. Frink Dairy Co.* (1927), 274 U.S. 445, 465; *Champ-
lin Ref. Co. v. Commission* (1931), 286 U.S. 210, 243.)

Due process requires that individuals be informed beforehand that particular action is forbidden and will subject them to penalties or other sanctions before such penalties and sanctions may be imposed.

In *Lanzetta v. New Jersey* (1939), 306 U.S. 451, in holding that a criminal statute was void by reason of vagueness and uncertainty, the Supreme Court said (p. 453):

"If on its face the challenged provision is repugnant to the due process clause, specification of details of the offense intended to be charged would not serve to validate it. Cf. *United States v. Reese*, 92 U. S. 214, 221; *Czarra v. Board of Medical Supervisors*, 25 App. D. C. 443, 453. It is the statute, not the accusation under it, that prescribes the rule to govern conduct and warns against transgression. See *Stromberg v. California*, 283 U. S. 359, 368; *Lovell v. Griffin*, 303 U. S. 444. No one may be required at peril of life, liberty or property to speculate as to the meaning of penal statutes. All are entitled to be informed as to what the State commands or forbids. The applicable rule is stated in *Connally v. General Construction Co.*, 269 U. S. 385, 391: 'That the terms of a penal statute creating a new offense must be sufficiently explicit to inform those who are subject to it what conduct on their part will render them liable to its penalties, is a well-recognized requirement, consonant

alike with ordinary notions of fair play and the settled rules of law. And a statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application, violates the first essential of due process of law.' "

CONCLUSION.

Respondent asserts the contract was not renewed or extended and was exempted under Section 102 of the Act.

We assert that Kangas was made a party to the proceeding before the Trial Examiner without proper *notice*.

We assert that Vollan and Lucy were not parties in the proceedings before the Trial Examiner and that Respondent has not been *accused* of any unfair labor practices as to them. Therefore, the Trial Examiner and the Board had no authority to include them for the purposes of relief.

Dated, Seattle, Washington,
March 14, 1952.

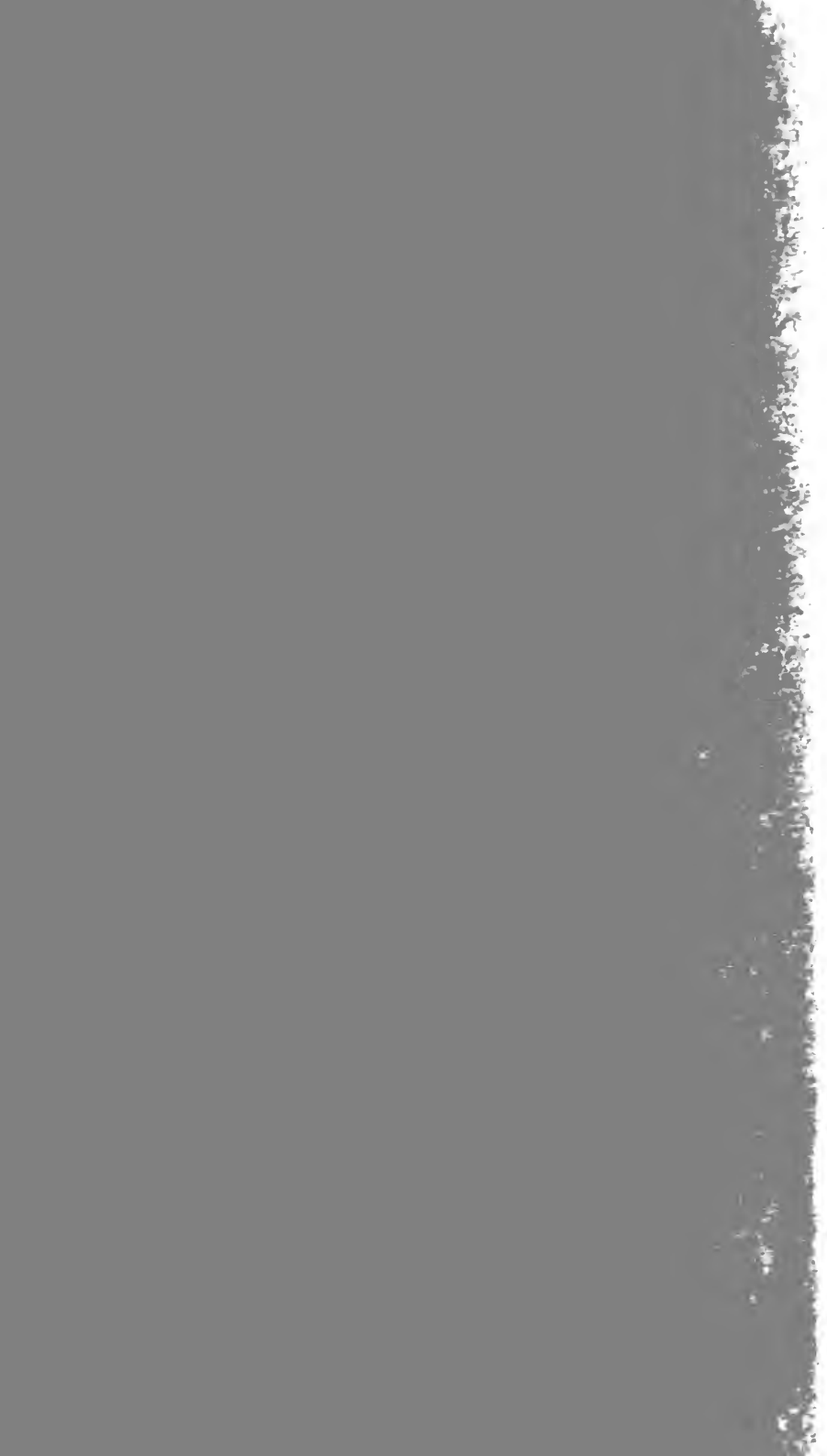
Respectfully submitted,

L. PRESLEY GILL,

Attorney for Respondent.

(Appendix Follows.)

Appendix.



Appendix

In the United States Court of Appeals
For the Ninth Circuit

No. 13,139

National Labor Relations Board,	}
vs.	
International Association of Heat and Frost Insulators and Asbestos Work- ers, Local No. 7, AFL,	
Petitioner, Respondent.	

AMENDED ANSWER TO PETITION FOR ENFORCEMENT OF AN ORDER OF THE NATIONAL LABOR RELATIONS BOARD

To the Honorable, the Judges of the United States
Court of Appeals for the Ninth Circuit:

The International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, respectfully answers the "Petition of the National Labor Relations Board for Enforcement of an Order of the National Labor Relations Board", as follows:

I.

That said Order is based on the Board's Findings of Fact, but the evidence was not substantial, nor did it preponderate in showing that the employer, Chas. R. Bower & Co. was engaged in interstate or foreign commerce or that the employer's operations substantially affected interstate commerce.

II.

That the said Order is based on a mistake of law in that the said Board did interpret the labor agreement between the Respondent and the employer as having been "renewed or extended subsequent" to the effective date of the National Labor Relations Act, as amended within the meaning of Section 102 of the Act.

III.

That the said Board committed prejudicial error in that its Trial Examiner Wilson received evidence of alleged discrimination against Vollan and Lucy as tending to prove or proving illegal discrimination against the persons named in the caption of this case. That the said Vollan and Lucy did not file any charge, nor was any complaint issued on their behalf. That the Board refused to strike such evidence and presumably considered it in the issuance of said Order.

IV.

That the Trial Examiner Wilson permitted amendment of the Consolidated Complaint over the objec-

tion of the Respondent, by adding the name of Uhro A. Kangas, by including his name in the title of the case and as a charging party. That the petitioner herein approved said amendments and entered its Cease and Desist Order, together with the requirement for payment of back wages for said individual.

V.

That the Trial Examiner and the said Board did include Alfred Vollan and LeRoy Lucy as parties to the proceeding without there having been any motion for said purposes and without any notice or hearing being accorded to the Respondent with respect to said persons. But, nevertheless, the Board issued its Cease and Desist Order and ordered the payment of back wages with respect to said individuals.

Wherefore, the Respondent having fully answered the Petition, prays that this Court dismiss the same, with costs to Respondent.

L. Presley Gill,
Attorney for Respondent.

Office and P. O. Address
2800 First Avenue
Seattle, Washington

United States of America,
State of Washington, County of King.—ss.

I, Thomas Roe, the President of the International Association of Heat and Frost Insulators and Asbestos Workers, Local No. 7, AFL, being the Respondent in the above entitled case, do hereby make solemn oath that the statements contained in the within and foregoing Amended Answer, are true to the best of my knowledge, information and belief.

Thomas E. Roe, Jr.

Subscribed and sworn to before me this 29th day of February, 1952.

L. Presley Gill,

Notary Public in and for the State
of Washington, residing at Seattle.

Filed March 7, 1952.

Paul P. O'Brien, Clerk.

No. 13142

IN THE

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT

GORDON DARCY,

Appellant,

v.

ROBERT A. HEINZE, etc.,

Appellee.

On Appeal From the United States District Court for the
Northern District of California, Northern Division

BRIEF FOR APPELLEE

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FILED

DEC 21 1951

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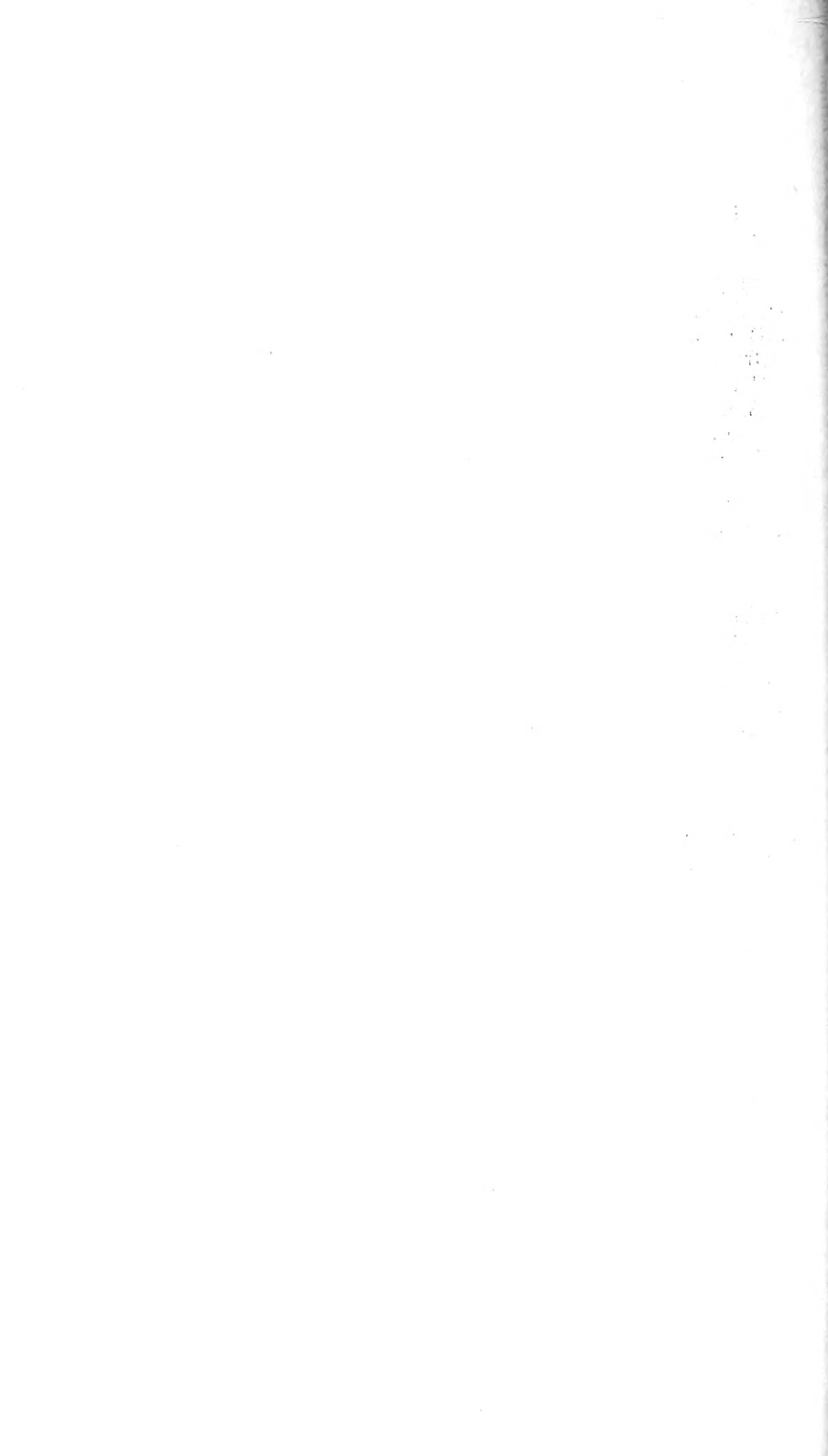
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No. 13142

IN THE

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT

GORDON DARCY,

Appellant,

v.

ROBERT A. HEINZE, etc.,

Appellee.

On Appeal From the United States District Court for the
Northern District of California, Northern Division

BRIEF FOR APPELLEE

STATEMENT OF THE CASE

On July 3, 1951, appellant filed a petition for writ of habeas corpus with the United States District Court, for the Northern District of California, Northern Division. (Tr. 1-52.) On July 16, 1951, Honorable Dal. M. Lemmon, Judge of the United States District Court for the Northern District of California, Northern Division, issued his order that the petition be dismissed on the ground that there was no allegation of exhaustion of state remedies which was a necessary allegation (Tr. 68). Thereafter and on July 28, 1951, appellant filed a motion to vacate order of dismissal

and to hear the petition for habeas corpus together with a request for a certificate of probable cause and permission to proceed in forma pauperis (Tr. 54-64, 69-71). On August 6, 1951, the Honorable Dal. M. Lemmon, District Judge, denied the motion to vacate order of dismissal of July 16, 1951, and further declined to issue a certificate of probable cause (Tr. 65). On August 22, 1951, the petition of appellant for leave to prosecute his appeal in forma pauperis was granted and a certificate of probable cause issued by this court (Tr. 66). On October 26, 1951, the record on appeal in this matter was filed with this court.

HISTORY OF PRIOR PROCEEDINGS

Petitioner was charged by an amended information by the District Attorney of Los Angeles County, with the crime of kidnapping for the purpose of robbery committed against Speropoulos and Simonsen, and it was alleged that they were subjected to bodily harm; and he was also charged with four other robbery counts, it being alleged that the acts occurred at the same time, and at which time defendant was armed with a deadly weapon, and said information also charged petitioner with three prior felony convictions. He pleaded not guilty to each count of the amended information and admitted the prior convictions. He was convicted on all five counts; the jury determined the punishment for kidnapping to be life imprisonment without parole and each of the robbery counts to be of the first degree. On the kidnapping

count, petitioner was sentenced to the penitentiary for life without possibility of parole, and on each of the robbery counts he was sentenced for the term prescribed by law, all counts to run concurrently.

People v. Darcy, 101 Cal. App. 2d 665, 669; 226 P. 2d 53.

On appeal to the District Court of Appeal of the State of California, in and for the Second Appellate District, he attacked his conviction on the following grounds: (1) that the evidence was insufficient to support the convictions; (2) error in admission of evidence; (3) error in instructions given; (4) that sentences were imposed for kidnapping and for robbery, whereas but one criminal offense was committed for which but one sentence could have been imposed.

On this appeal, the District Court of Appeal of the State of California, in and for the Second Appellate District, affirmed the judgment of the trial court upon the petitioner for kidnapping for the purpose of robbery, while armed, and with violence, as charged in Count 1 of the information; reversed the robbery counts charged against the petitioner in Counts 2 and 5 of said information and affirmed the robbery counts charged in Counts 3 and 4 of said information.

People v. Darcy, 101 Cal. App. 2d 665, 673; 226 P. 2d 53.

A petition for hearing by the California Supreme Court was denied in this matter on February 8, 1951.

People v. Darcy, 101 Cal. App. 2d 665, 673; 226 P. 2d 53.

On both the trial and on appeal petitioner was represented by counsel. No petition for writ of certiorari to review this decision was sought by the petitioner herein from the United States Supreme Court.

Thereafter, and on May 4, 1951, petitioner filed a petition for writ of habeas corpus with the California Supreme Court, numbered Crim. 5225 on the files of said court, which petition alleged the same grounds of illegality of the state court decision as were sought to be presented in the petition for writ of habeas corpus filed herein, namely, (1) that the prosecuting attorney used illegal means and methods to secure the conviction by introducing evidence as to petitioner's prior felony convictions after he had admitted the same; (2) that he was forced to stand trial for a capital offense without having been given a preliminary examination upon said charge; (3) that he was denied the assistance of counsel since his court-appointed counsel did not render effective aid in his defense; and (4) that in view of the circumstances surrounding the case the sentence imposed upon him was cruel and unusual punishment within the meaning of the Eighth Amendment to the United States Constitution. This petition was denied without opinion by the California Supreme Court on May 17, 1951.

No petition for writ of certiorari to review said action of the California Supreme Court was sought by the petitioner herein from the United States Supreme Court.

Instead, on July 3, 1951, he sought a petition for writ of habeas corpus from the United States District Court, for the Northern District of California, Northern Division. (Tr. 1-52.)

SPECIFICATION OF ERROR

Appellant contends that the District Court erred in dismissing his petition for a writ of habeas corpus upon the ground that he did not apply to the United States Supreme Court for a writ of certiorari and in claiming that such was a necessary allegation to show the exhaustion of state remedies.

SUMMARY OF ARGUMENT

- I. The Procedure Followed by the District Court in Denying the Petition Without a Hearing Was Proper Under the Statute
- II. The Allegations of the Petition for Writ of Habeas Corpus Were Insufficient as Grounds for the Issuance of a Writ
- III. Appellant Did Not Exhaust His State Remedies or Demonstrate That Circumstances of Peculiar Urgency Exist

ARGUMENT

- I. The Procedure Followed by the District Court in Denying the Petition Without a Hearing Was Proper Under the Statute

In the case of *Dorsey v. Gill*, 148 F. 2d 857 (cert. den. 325 U. S. 890), the United States Court of Appeals for the District of Columbia, examined at great length the office and nature of a writ of habeas corpus and the procedure to be followed in federal courts upon an application therefor. The opinion (which is exhaustively annotated and which is noted in *Darr v. Burford*, 339 U. S. 200, 70 S. Ct. 587) summarized

the procedure which may be followed by a district court on a petition for the issuance of a writ of habeas corpus and stated (pp. 865-866):

“There are at least ten such possible alternatives, as follows: (1) When a petition is presented to a judge with a request for leave to file it, the judge may, if the petitioner is not entitled to a writ, deny leave to file it; or (2) he may in the interest of justice—if the petition is insufficient in substance—require petitioner to amend it; or he may require him to show—if the judge is not otherwise informed—whether petitioner has made a prior application and, if so, what action was had on it; (3) he may issue a rule to show cause why leave to file a petition for writ of habeas corpus should not be granted and upon the return, may grant or deny leave to file; (4) after a petition has been filed, if it satisfies the requirements of the statute, the judge should issue the writ forthwith; (5) if, upon consideration of a petition which has been filed, it appears that the petitioner is not entitled to the writ, the court should refuse to issue it; (6) if the allegations of the petition are inconclusive, the judge may issue a rule to show cause why a writ should not be granted, to which the relator may respond; (7) if the procedure suggested in (6) is followed, the facts on which the opposing parties rely having been exhibited to the judge, he may find that no issue of fact or law is involved and may then refuse to grant the writ, in which event it is not necessary to hold a hearing; (8) on the other hand, if the procedure suggested in (6) is followed, the judge may find that the facts admitted—in response to

the order to show cause—entitled the petitioner to the writ and to a discharge, forthwith, as a matter of law; or (9) he may find that an issue is involved; in which event he should grant the writ and require a hearing, the petition and traverse being then treated as, together, constituting the application for the writ, the return to the rule as setting up the facts thought to warrant its denial, and the issues of fact, thus emerging, should be tried as required by that statute; (10) if, as a matter of convenience, the judge—without determining whether the petition is sufficient—issues the writ, he may then, upon the return, hear and dispose of the whole matter at once.”

The District Court in the instant matter acted under alternative (5) set forth in *Dorsey v. Gill*, 148 F. 2d 857, having considered the petition which had been filed and which showed on its face that the petitioner and appellant herein was not entitled to the writ and found that since there was no necessary allegation of exhaustion of state remedies, the petition should be dismissed (Tr. 68).

From the record of the proceedings heretofore had in this matter and of which the United States District Court could take judicial notice (*Knight v. People*, 60 F. Supp. 164; *Tatè v. Heinze*, 187 F. 2d 98) it appears that the appellant was charged and convicted in the state courts with four counts of robbery and one of kidnapping for the purpose of robbery, while armed with a deadly weapon, and inflicting bodily harm on the victims as well as three prior felony

convictions and the service of sentence therefor in a state penitentiary. He was represented by counsel at the trial and on appeal.

On appeal, the District Court of Appeal of the State of California, in and for the Second Appellate District, affirmed the judgment imposed upon appellant for kidnapping for the purpose of robbery, while armed, and with violence as charged in Count 1 of the information; reversed the judgment as to Counts 2 and 5 (robbery), and affirmed Counts 3 and 4 as to robbery. (*People v. Darcy*, 101 Cal. App. 2d 665; 226 P. 2d 53). A petition for hearing in the California Supreme Court was denied on February 8, 1951 (*People v. Darcy*, 101 Cal. App. 2d 665, 673; 226 P. 2d 53).

On May 4, 1951, petitioner and appellant filed a petition for writ of habeas corpus with the California Supreme Court and numbered therein Crim. 5225 attacking the validity of the judgment and commitment under which he was confined on the same grounds as he presented in the application under consideration here.

This petition for writ of habeas corpus was denied without opinion by the California Supreme Court on May 17, 1951. No petition for certiorari to review this decision was sought from the United States Supreme Court.

The petition on its face in the instant matter presents no grounds which have not or could not have been presented hitherto to the state courts on the

original appeal and to the California Supreme Court on the petition for hearing and on habeas corpus both of which were denied. The grounds presented were within the knowledge of the appellant at the time of his original appeal in the state courts.

Salinger v. Loisel, 265 U. S. 224, 230; 44 S. Ct. 519;

Darr v. Burford, 339 U. S. 200, 70 S. Ct. 587.

It is apparent that on its face the petition does not comply with the provisions of Section 2254, Title 28, United States Code which provides:

“An application for a writ of habeas corpus in behalf of a person in custody pursuant to the judgment of a State court shall not be granted unless it appears that the applicant has exhausted the remedies available in the courts of the State, or that there is either an absence of available State corrective process or the existence of circumstances rendering such process ineffective to protect the rights of the prisoner.

“An applicant shall not be deemed to have exhausted the remedies available in the courts of the State, within the meaning of this section, if he has the right under the law of the State to raise, by any available procedure, the question presented.”

In *Darr v. Burford*, 339 U. S. 200; 70 S. Ct. 587, 94 L. Ed. 761, the United States Supreme Court enunciated the rule that accustomed procedure required a petition for certiorari to be made to the United States Supreme Court from a state court's

refusal of collateral relief before a federal district court would consider an application for habeas corpus on its merits. The court there stated (339 U. S. 200, 210-14) :

“In Sec. 2254 of the 1948 recodification of the Judicial Code, Congress gave legislative recognition to the *Hawk* rule for the exhaustion of remedies in the state courts and this Court. This was done by embodying in the new statute the rulings drawn from the precedents. The rulings had been definitely restated in *Hawk*. That case had represented an effort by this Court to clear the way for prompt and orderly consideration of habeas corpus petitions from state prisoners. This Court had caused the *Hawk* opinion to be distributed to persons seeking federal habeas corpus relief from state restraint and the opinion had been generally cited and followed. There is no doubt that Congress thought that the desirable rule drawn from the existing precedents was stated by *Hawk*, for the statutory reviser’s notes inform us that

‘This new section is declaratory of existing law as affirmed by the Supreme Court. (See *Ex parte Hawk*, 1944, 64 S. Ct. 448, 321 U. S. 114, 88 L. Ed. 572.)’

“While this section does not refer expressly to the requirement for application to this Court for review, it must be read in the light of the statement quoted on p. 207, *supra*, from *Hawk*. So read, there was occasion neither for the draftsmen of Sec. 2254 to make reference to review in this Court, nor for the committees of the House or Senate or members of Congress to comment upon

it. It is immaterial whether as a matter of terminology it is said that review in this Court of a state judgment declining relief from state restraint is a part of the state judicial process which must be exhausted, or whether it is said to be a part of federal procedure. The issue cannot be settled by use of the proper words. *Hawk* treated review here as a state remedy. *Wade* thought it was not state procedure. But undoubtedly review here is a part of the process by which a person unconstitutionally restrained of his liberty may secure redress. *Ex parte Hawk* had made it clear that all appellate remedies available in the state court and in this Court must be considered as steps in the exhaustion of the state remedy in the sense that the term is used, perhaps inexactly, in the field of habeas corpus. Consideration of the legislative history of Sec. 2254 reveals no suggestion that the draftsmen intended to alter the sense of the term as defined in *Hawk* or to differentiate between exhaustion of state remedies and review in this Court. All the evidence manifests a purpose to enact *Hawk* into statute. The reviser's notes, explicitly stating this purpose, remained unchanged throughout the bill's legislative progress. So did the statement of the exhaustion principle contained in the first paragraph of Sec. 2254 down to the first 'or'. None of the changes or additions made by the Senate to Sec. 2254 affected the problem of review here. They were directed at other issues.

“It seems sure that Congress drafted and enacted Sec. 2254 expecting review here in conformity with the *Hawk* rule. Nothing indicates to us

a desire on the part of Congress to modify the language. We think the rule of the *Hawk* case that ordinarily requires an effort to obtain review here has been accepted by Congress as a sound rule to guide consideration of habeas corpus in federal courts.”

The court also stated (pp. 216-17) :

“The answer to petitioner’s argument that he should not be required to seek review here from a state’s refusal to grant collateral relief before applying to other federal courts involves a proper distribution of power between state and federal courts. The sole issue is whether comity calls for review here before a lower federal court may be asked to intervene in state matters. We answer in the affirmative. Such a rule accords with our form of government. Since the states have the major responsibility for the maintenance of law and order within their borders, the dignity and importance of their role as guardians of the administration of criminal justice merits review of their acts by this Court before a prisoner, as a matter of routine, may seek release from state process in the district courts of the United States. It is this Court’s conviction that orderly federal procedure under our dual system of government demands that the state’s highest courts should ordinarily be subject to reversal only by this Court and that a state’s system for the administration of justice should be condemned as constitutionally inadequate only by this Court. From this conviction springs the requirement of prior application to this Court to avoid unseemly interference by

federal district courts with state criminal administration.”

It is patent in the case at bar that the petitioner and appellant herein has attempted to circumvent the requirements of Section 2254 of Title 28, U. S. C., for he has neither sought certiorari from the United States Supreme Court to review the judgment of the highest state court on his original appeal (*People v. Darcy*, 101 Cal. App. 2d 665; 226 P. 2d 53), nor has he sought certiorari from the United States Supreme Court as to the decisions of the California Supreme Court in his collateral attack on the judgment by means of his petition for habeas corpus (Crim. 5225, Cal. Supreme Ct.).

Under the decisions of *Ex parte Hawk*, 321 U. S. 114, *White v. Ragen*, 324 U. S. 760, *Darr v. Burford*, 339 U. S. 200, and Sec. 2254 of Title 28 U. S. C., the petitioner and appellant has not exhausted his state remedies and his application in the Federal District Court was properly dismissed.

II. The Allegations of the Petition for Writ of Habeas Corpus Were Insufficient as Grounds for the Issuance of a Writ

The petition for writ of habeas corpus herein alleges that the conviction in the state courts was illegal and void on the following grounds: (1) that petitioner's trial in the superior court was not fair and impartial and was contrary to the provisions of the Sixth and Fourteenth Amendments to the Constitution of the United States in that the prosecuting

attorney used illegal means and methods of obtaining the conviction by the introduction of evidence contrary to the provisions of Sections 1025 and 1093 of the California Penal Code and Section 2051 of the California Code of Civil Procedure; (2) that the petitioner was forced to stand trial for a capital offense without having said charge submitted for inquiry before a committing magistrate, nor was he committed by any committing magistrate for a capital offense; (3) that his court-appointed attorney did not render effective aid in petitioner's defense and therefore petitioner was denied the assistance of counsel within the constitutional meaning of that term; and (4) in view of the circumstances of this case the sentence imposed upon petitioner amounted to cruel and unusual punishment within the meaning of the Eighth Amendment to the Constitution of the United States (Tr. 2-4).

A. THE TRIAL OF PETITIONER WAS NOT IN VIOLATION OF EITHER THE FEDERAL OR STATE CONSTITUTIONS

As to the appellant's first contention that by reason of the admission of certain improper evidence, his trial was unfair and not impartial, this point was presented to the District Court of the State of California, in and for the Second Appellate District, on appellant's original appeal and the ruling of the District Court thereon was as follows (*People v. Darcy*, 101 Cal. App. 2d 665, pp. 670-672; 226 P. 2d 53):

“At the close of direct examination of defendant, counsel for the People read to the jury records of three prior convictions which defendant

admitted he had suffered. This was for impeachment under section 2051, Code of Civil Procedure. One of these records showed that defendant was on parole at the time of the commission of the crimes charged.

“The documents consisted of (1) the certification of Clinton T. Duffy, Warden of San Quentin Prison, as to his official position, that he has in his custody records pertaining to defendant, when defendant was received at San Quentin, under commitment from what court and for what offenses, the date his terms were fixed and what they were, the date he was paroled and discharged from parole, that the copies of the commitment and fingerprints attached are true and correct copies of originals in his custody; (2) fingerprint card with defendant’s signature; (3) photograph of defendant under prison number; (4) copy of judgment in Superior Court action number 70634, Los Angeles County; (5) copy of judgment in same case, another count; (6) copy of judgment in same case, another count; (7) copy of judgment in Superior Court action number 73421 before same judge; (8) the certification of Richard A. McGee, Director of the Department of Corrections, as to his official position, that he has in his custody records pertaining to defendant, when defendant was received at San Quentin, under commitment from what court, for what offense, the date his term was fixed and for how long, the date he was released on parole, that the copies of the commitment and fingerprints attached are true and correct copies of originals in his custody; (9) copy of judgment in a Santa Clara Superior Court

proceeding; (10) order to sheriff to take prisoner; (11) fingerprint card bearing defendant's signature; (12) photograph bearing prison number.

"Objection was made and overruled, that the foregoing records from San Quentin and Folsom were indecipherable; but no objection was made to this method of procedure, and no motion to strike was made. The district attorney did not read all of the documents, but from parts only of some of them.

"When a defendant in a criminal case offers himself as a witness he may be impeached on cross-examination by asking him if he has been convicted of a felony, or by showing the fact, if it exists, by *the record of the judgment*. (Italics added.) (Code Civ. Proc., Sec. 2051; *People v. Williams*, 27 Cal. 2d 220 (163 P. 2d 692); *People v. Peete*, 28 Cal. 2d 306 (169 P. 2d 924); *People v. Craig*, 196 Cal. 19 (235 P. 721); *People v. Sears*, 119 Cal. 267 (51 P. 325); *People v. Brancato*, 83 Cal. App. 2d 734 (189 P. 2d 504).) But beyond this the examination should not go. (*People v. Chin Hane*, 108 Cal. 597 (41 P. 697).)

"There should be no difficulty about what the code means when it says the 'record of the judgment.' Defendant's records in the penitentiary, his prison photographs and fingerprints, should not have been read to the jury. However, after examination of the entire case this court is not of the opinion that the error resulted in a miscarriage of justice. (Const., art. VI, Sec. 4½.)

"It is true that from a reading of the entire record in this case we are unable to say that the errors just set forth may have turned the scale

in favor of the prosecution, because the evidence of appellant's guilt was overwhelming. Therefore, it must be held that, in spite of palpable error in the admission of the criticized portion of appellant's criminal record, there was no miscarriage of justice.

"However, we cannot refrain from administering a deserved rebuke for the offer of and receipt in evidence of appellant's record in the penitentiary, his prison photographs and fingerprints. It would be an impeachment of the legal learning of counsel for the People to intimate that he did not know the introduction of the just mentioned record to be improper, wholly unjustifiable, and peculiarly calculated to prejudice the substantial rights of appellant. Such conduct tends only to prevent the accused from having that fair and impartial trial to which, whether innocent or guilty, he is entitled. Moreover, it may defeat the punishment of crime by jeopardizing a conviction when a defendant is clearly guilty. It is obvious that the questioned portions of appellant's prison record were injected into the case for the manifest purpose of prejudicing the jury against him. It is only because we are unable to say that the conviction herein might have resulted from the foregoing disregard of appellant's essential rights, that we are not compelled to reverse the judgments."

It thus appears that the first contention sought to be urged by the appellant was directly presented to the California courts on appellant's original appeal and the action of the district attorney found *not* to be that degree of prejudicial error as would warrant a

reversal under Article VI, Section 4½, of the California Constitution as it did not result in a substantial deprivation of appellant's constitutional rights in view of the overwhelming evidence of his guilt under the circumstances. The California Supreme Court in denying the petition for hearing in said matter impliedly agreed with the decision of the District Court of Appeal. Petitioner and appellant by not seeking a review of this decision by the United States Supreme Court on certiorari where the matter appeared on the face of the state record clearly did not exhaust his state remedies.

White v. Ragen, 324 U. S. 760, 89 L. Ed. 1348, 65 S. Ct. 978;

In re Miller (9 Cir.), 126 F. 2d 826 (cert. den. 316 U. S. 677, 86 L. Ed. 1751, 62 S. Ct. 1107, reh. den. 316 U. S. 713, 86 L. Ed. 1778, 62 S. Ct. 1307);

Morgan v. Horall (9 Cir.), 175 F. 2d 404 (cert. den. 338 U. S. 827, 94 L. Ed. 503, 70 S. Ct. 76);

Darr v. Burford, 339 U. S. 200, 94 L. Ed. 761, 70 S. Ct. 587, and annotation to 94 L. Ed. 785-795.

B. APPELLANT WAS NOT FORCED TO STAND TRIAL FOR A CAPITAL OFFENSE WITHOUT AN EXAMINATION BY A COMMITTING MAGISTRATE

Petitioner and appellant alleges that he was charged in an information filed by the District Attorney of the County of Los Angeles, State of California, with four counts of robbery while armed with a deadly weapon, and with three prior convictions;

that some 33 days after his arraignment on the information, he was taken before the Superior Court of the State of California, in and for the County of Los Angeles, and the district attorney amended the information to charge in count one thereof kidnapping for the purpose of robbery as well as four counts of robbery and three prior convictions (Tr. 5); that he was arraigned on the amended information and the following day his trial began (Tr. 5); that as a result thereof he was not given a preliminary examination on the kidnapping charge and this resulted in a lack of due process.

Section 1008 of the Penal Code of the State of California * provided that an information may be amended by the district attorney without leave of court, at any time before a defendant pleads and the court may order its amendment for any defect or insufficiency at any stage of the proceedings; however an information may not be amended so as to charge an offense not shown by the evidence taken at the preliminary examination.

Section 995 of the Penal Code provides for the setting aside of an information where the defendant has not been legally committed by a magistrate or has been committed without reasonable and probable cause and upon denial thereof under the provisions of Section 999a of the Penal Code, an application for a writ of prohibition may be made by the defendant to the appellate court.**

* Section 1008. See Appendix.

** See Appendix, Section 999a, California Penal Code.

Where no motion under Section 995 of the Penal Code has been made a defendant may not raise the point for the first time on appeal and clearly may not collaterally attack such ruling on habeas corpus.

In re Connor, 16 Cal. 2d 701, 108 P. 2d 10;

In re Northcott, 71 Cal. App. 281, 235 P. 458.

In the instant matter, there was no question but that the evidence at the time of trial supported the verdict of the trial court finding the petitioner guilty of kidnapping for the purpose of robbery. The District Court of Appeal in *People v. Darcy*, 101 Cal. App. 2d 665, 226 P. 2d 53, stated (p. 669):

“The objection that the evidence is insufficient may be summarily disposed of. The record has been read, and supports beyond all reasonable doubt the findings of the jury.”

The writ of habeas corpus cannot be used for the purpose of proceedings in error and it is apparent that the sufficiency of the evidence to support the conviction may not be inquired into under the writ (*Burall v. Johnson*, 134 Fed. 2d 614 (cert. den. 63 S. Ct. 1327, 319 U. S. 768)); *Sunal v. Large*, 332 U. S. 174, 67 S. Ct. 1588; *Frank v. Mangum*, 237 U. S. 309, 35 S. Ct. 582), so patently on habeas corpus an inquiry cannot be made into the sufficiency of the evidence adduced at a preliminary examination to support an information for a charge of kidnapping and robbery.

In re Northcott, 71 Cal. App. 281, 235 P. 458;
In re Weintraub, 61 Cal. App. 2d 666, 143 P.
2d 936.

Thus petitioner and appellant's second contention does not involve a constitutional question nor result in the deprivation of petitioner's life, liberty, or property, without due process of law.

C. PETITIONER AND APPELLANT WAS NOT DENIED THE EFFECTIVE ASSISTANCE OF COUNSEL

Petitioner and appellant's contention that he was denied the effective assistance of counsel which amounted to a lack of counsel and thus due process of law, is not borne out by the record.

The record discloses that the petitioner and appellant herein did not raise the question of his counsel's competence on the appeal from the original judgment although he was represented by different counsel at the time of the appeal (*People v. Darcy*, 101 Cal. App. 2d 665, 226 P. 2d 53). This point was sought to be raised by petitioner in his petition for habeas corpus to the California Supreme Court (Cr. 5225).

Petitioner urges that the record discloses his counsel at trial, a deputy public defender appointed by the court, was so incompetent that his assistance amounted to no assistance and therefore petitioner and appellant was denied the right to counsel.

When a public defender is appointed to represent a defendant accused of a crime, he becomes the attorney for said defendant for all purposes of the case and to the same extent as if regularly retained and employed

by the defendant. He is as free to act in behalf of his client as if he had been regularly employed and retained by the defendant whom he represents. Were this not so his client would not be afforded the full right "to have assistance of counsel for his defense" which the Constitutions, both state and federal, give to one accused of crime. With such plenary powers given a public defender when appointed to defend one accused of crime, it necessarily follows that no act of his in advising his client or in defending the latter upon the charge against him can be considered in any different light than if such act were performed by an attorney regularly employed and retained by the defendant.

In re Hough, 24 Cal. 2d 522.

In the instant case, the record does not disclose that counsel for petitioner and appellant was so lacking in competence as to amount practically to no defense at all. It is only in such case that the failure of the trial judge or prosecuting attorney to observe and correct it would be a denial of a fair trial and of due process of law. An extreme case must be shown; one where the circumstances surrounding the trial shocked the conscience of the court and made the proceedings a farce and a mockery of justice (*Diggs v. Welch*, 148 F. 2d 667 (cert. den. 325 U. S. 889, 65 S. Ct. 1576, 89 L. Ed. 2002); *Andrews v. Robertson*, 145 F. 2d 101-103). This petitioner and appellant has not demonstrated by the record.

Allegations of even serious mistakes on the part of defense counsel, that he failed to have a defendant testify or offer testimony in his behalf; failed to properly prepare for trial or obtain available evidence; or did not ask for a change of venue or continuance, or take an appeal are not sufficient in and of themselves to warrant habeas corpus.

Morton v. Welch (4 Cir.) 162 Fed. 2d 840-2;
Ex parte Haumesch (9 Cir.) 82 Fed. 2d 558;
Farrell v. Lanagan (1 Cir.) 166 Fed. 2d 845-7;
23 C. J. S. Criminal Law, Sec. 1443;
24 C. J. S., Criminal Law, Sec. 1948, p. 1112.

Neither the state courts on the trial, on appeal, or on habeas corpus found there was anything remotely suggesting lack of professional skill, ability, loyalty, or devotion of defense counsel to the petitioner and his cause. The federal courts are not charged with a review of the strategy of defense counsel (*Burkett v. Mayo*, (5 Cir.) 173 Fed. 2d 574). A defendant is entitled to a fair trial, not a perfect one. His counsel is not required to be infallible.

U. S. ex rel. Feeley v. Ragen, (7 Cir.) 166 Fed. 2d 976.

This is not a case of waiver of counsel but one where the precise question is presented by the record and was before the trial court. It could have been raised on appeal but petitioner and appellant did not so do. The record discloses that appellant had the effective aid and assistance of counsel. There was a judicial atmosphere throughout the proceedings and

the hearing at which petitioner was afforded an opportunity to be heard, to examine the witnesses against him, and to offer testimony was a real one and not a sham or pretense.

Petitioner and appellant was not, therefore, in the light of the decisions interpreting the Fourteenth Amendment deprived of due process of law.

In re Oliver, 333 U. S. 257, 273; 68 S. Ct. 499; 92 L. Ed. 682;

Powell v. Alabama, 287 U. S. 45, 68-70; 53 S. Ct. 55; 77 L. Ed. 158; 84 A. L. R. 527;

Hawk v. Olson, 326 U. S. 271, 273-4; 66 S. Ct. 116; 90 L. Ed. 61;

House v. Mayo, 324 U. S. 42, 46; 65 S. Ct. 517; 89 L. Ed. 739;

Ex parte Hawk, 321 U. S. 114, 115-6; 64 S. Ct. 448; 88 L. Ed. 572.

D. THE SENTENCE IMPOSED UPON PETITIONER DID NOT RESULT IN CRUEL AND UNUSUAL PUNISHMENT CONTRARY TO THE EIGHTH AMENDMENT TO THE FEDERAL CONSTITUTION

Section 209 of the California Penal Code, as in effect at the date of the petitioner's conviction, read as follows:

Every person who seizes, confines, inveigles, entices, decoys, abducts, conceals, kidnaps or carries away any individual by any means whatsoever with intent to hold or detain, or who holds or detains, such individual for ransom, reward or to commit extortion or robbery or to exact from relatives or friends of such person any money or valuable thing, or who aids or abets any such act, is guilty of a felony and upon conviction thereof shall suffer death or shall be punished by

imprisonment in the State prison for life without possibility of parole, at the discretion of the jury trying the same, in cases in which the person or persons subjected to such kidnaping suffers or suffer bodily harm or shall be punished by imprisonment in the State prison for life with possibility of parole in cases where such person or persons do not suffer bodily harm.”

The constitutionality of this section was upheld by the California Supreme Court in the case of *People v. Tanner*, 3 Cal. 2d 279, 44 P. 2d 324.

In the case of *Bailey v. United States*, 74 Fed. 2d 451, in answering a similar contention, the court stated (p. 452):

“The fixing of penalties for crime is a legislative function. What constitutes an adequate penalty is a matter of legislative judgment and discretion, and the courts will not interfere therewith unless the penalty prescribed is clearly and manifestly cruel and unusual. Where the sentence imposed is within the limits prescribed by the statute for the offense committed, it ordinarily will not be regarded as cruel and unusual . . . (citing authorities) . . . Kidnaping is a heinous offense. A sentence to life imprisonment for transporting a kidnapped victim in interstate commerce, or for conspiracy so to transport a kidnapped victim, is not, in our opinion, cruel and unusual punishment within the constitutional inhibition.”

Thus it appears that petitioner's contention in this regard is without merit as the sentence imposed upon him was within the limits prescribed by the statute

for the offense committed and has been upheld as not cruel and unusual punishment.

Hubbard v. Jacques, 95 Fed. Supp. 894.

Moreover, it should be noted that no such contention as is urged herein was urged by petitioner on his appeal from the original judgment of conviction where under state law he would have had full opportunity to raise such point.

III. The Petitioner and Appellant Did Not Exhaust His State Remedies or Demonstrate That Circumstances of Peculiar Urgency Exist

In accordance with the mandate of *Darr v. Buford*, 339 U. S. 200, 70 S. Ct. 587, 94 L. Ed. 761; *Ex parte Hawk*, 321 U. S. 114, 64 S. Ct. 448, 88 L. Ed. 572, and Section 2254, Title 28 U. S. C., the United States District Court dismissed the instant petition which on its face disclosed that petitioner had failed to seek a writ of certiorari from the United States Supreme Court to review the highest state court decision on its merits (*People v. Darcy*, 101 Cal. App. 2d 665, 226 P. 2d 53), or to review the denial without opinion of his petition for writ of habeas corpus by the California Supreme Court in which the identical questions were sought to be presented.

In *Darr v. Buford*, 339 U. S. 200, 70 S. Ct. 587, 94 L. Ed. 761, the court stated (p. 216):

“Though our denial of certiorari carry no weight in a subsequent federal habeas corpus proceeding,

we think a petition for certiorari should nevertheless be made before an application may be filed in another federal court by a state prisoner. The requirement derives from the basic fact that this republic is a federation, a union of states that has created the United States. We have detailed the evolution of and the reason for the conclusion that the responsibility to intervene in state criminal matters rests primarily upon this Court. It is this Court which ordinarily should reverse state court judgments concerning local criminal administration. The opportunity to meet that constitutional responsibility should be afforded. Even if the District Court may disregard our denial of certiorari, the fact that power to overturn state criminal administration must not be limited to this Court alone does not make it less desirable to give this Court an opportunity to perform its duty of passing upon charges of state violations of federal constitutional rights. This Court has evolved a procedure which assures an examination into the substance of a prisoner's protest against unconstitutional detention without allowing destructive abuse of the precious guaranty of the Great Writ. Congress has specifically approved it. Though a refusal of certiorari have no effect upon a later application for federal habeas corpus, a petition for certiorari here ordinarily should be required. The answer to petitioner's argument that he should not be required to seek review here from a state's refusal to grant collateral relief before applying to other federal courts involves a proper distribution of power between state and federal courts. The sole issue is whether comity calls for

review here before a lower federal court may be asked to intervene in state matters. We answer in the affirmative. * * *

“It is this Court’s conviction that orderly federal procedure under our dual system of government demands that the state’s highest courts should ordinarily be subject to reversal only by this Court and that a state’s system for the administration of justice should be condemned as constitutionally inadequate only by this Court. From this conviction springs the requirement of prior application to this Court to avoid unseemly interference by federal district courts with state criminal administration.”

Since the face of the instant petition discloses that the petitioner neither sought review by certiorari from the United States Supreme Court of the highest state court judgment on the appeal from his original conviction nor from the California Supreme Court’s denial of his petition for writ of habeas corpus wherein the same points were presented, it is apparent that the United States District Court was not in error in dismissing the petition for writ of habeas corpus. (See, Annotation 88 L. Ed. 576-596 and 94 L. Ed. 785-795 and cases cited.)

A. THE PETITIONER DID NOT BEAR HIS BURDEN OF SHOWING
EXTRAORDINARY CIRCUMSTANCES OF PECULIAR URGENCY ON
THE FACE OF HIS PETITION

Under the provisions of Section 2254, Title 28 U. S. C. the federal courts may in exceptional cases, even though technically the state remedies have not been exhausted by the petitioner, entertain a habeas

corpus petition when there is “either an absence of available state corrective process or the existence of circumstances rendering such process ineffective to protect the rights of the prisoner.”

That there is an available state corrective process in California by habeas corpus is well recognized (*Mooney v. Holohan*, 294 U. S. 103, 55 S. Ct. 340, 79 L. Ed. 791).

An examination of the grounds of the petition in the instant matter, namely, (1) that the conviction was based upon inadmissible evidence rendering the trial unfair as to petitioner and hence a lack of due process; (2) that he was not properly committed by a committing magistrate; (3) that he was denied the effective assistance of counsel; and (4) that the punishment imposed upon him was cruel and inhuman and thus contrary to the Eighth Amendment to the Federal Constitution, together with the prior records in his action, namely, *People v. Darcy*, 101 Cal. App. 2d 665, 226 P. 2d 53, and Crim. 5225, California Supreme Court, disclose that they clearly do not present circumstances of “peculiar urgency” requiring prompt federal intervention.

Essential unfairness should not be a matter of speculation but of demonstrable reality. (*Buchalter v. New York*, 319 U. S. 427, 63 S. Ct. 1129, 87 L. Ed. 1492; *Adams v. U. S. ex rel. McCann*, 317 U. S. 269, 281, 63 S. Ct. 236, 87 L. Ed. 268. The instant case does not fall in the classification of *Frank v. Mangum*, 237 U. S. 309, 35 S. Ct. 582, 59 L. Ed. 969, and

Shepherd v. State of Florida, 341 U. S. 50, 71 S. Ct. 549), where there was a trial dominated by a mob so that there was an actual interference with the course of justice and hence a departure from due process of law. In this matter the whole proceeding was not a mask, where counsel, jury, and judge were swept to the fatal end by an irresistible wave of public passion. The defendant was not prejudged as guilty nor was his trial a legal gesture to register a verdict already dictated by the press or the public opinion which it generated. In the words of Mr. Justice Holmes in *Ashe v. United States ex rel. Vellota*, 270 U. S. at 426, 46 S. Ct. at 334:

“Extraordinary cases where there is only the form of court under the domination of a mob * * * offers no analogy to this.”

In *Soulia v. O'Brien*, 91 Fed. Supp. 965, at 967, in considering the effect of the proviso to Section 2254, Title 28 U. S. C., the court stated:

“In general he (petitioner) appears to argue that if the alleged constitutional violation is an extremely flagrant one, that fact will bring the case within the exception. This argument must be rejected. The ‘special circumstances’ justifying the exception can only be such circumstances as would make the application for certiorari a formal and futile proceeding, certain beforehand to result only in a denial. Cf. *White v. Ragen*, 324 U. S. 760, 65 S. Ct. 978, 89 L. Ed. 1348.”

A bare constitutional question is alone not enough. (*United States ex rel. Murphy v. Murphy*, 108 Fed.

2d 861, (cert. den. *Murphy v. Warden of Clinton State Prison*, 309 U. S. 661, 60 S. Ct. 583, 84 L. Ed. 1009); *Knewel v. Egan*, 268 U. S. 442, 45 S. Ct. 522, 69 L. Ed. 1036.) Nor can mere convenience justify the writ as a substitute for an appeal (*Adams v. U. S. ex rel. McCann*, 317 U. S. 269, 274, 63 S. Ct. 236, 239, 87 L. Ed. 268, 143 A. L. R. 435; *Urquhart v. Brown*, 204 U. S. 179, 27 S. Ct. 459, 51 L. Ed. 760).

In the case of *U. S. ex rel. Auld v. Warden of New Jersey State Penitentiary*, 187 Fed. 2d 615, 618, the court held that the fact the relator had been sentenced to death was not sufficient, even though the State Supreme Court had denied the petition on its merits as long as the avenue of certiorari to the Supreme Court of the United States remained open.

The facts and circumstances presented in the case at bar disclose no situation of peculiar urgency requiring prompt intervention.

Sunal v. Large, 332 U. S. 174, 178-181, 184-7, 67 S. Ct. 1588, 91 L. Ed. 1982;

United States ex rel. Kennedy v. Tyler, 269 U. S. 13, 17, 46 S. Ct. 1, 70 L. Ed. 138;

Tinsley v. Anderson, 171 U. S. 101, 104-5, 18 S. Ct. 805, 43 L. Ed. 91.

CONCLUSION

Appellee submits that a review of the record in the case at bar discloses that the action of the Federal District Court was correct in finding that petitioner had not exhausted his state remedies which was a prerequisite to his seeking relief from the District

Court where, as here, the face of the petition did not disclose circumstances of peculiar urgency requiring the intervention of a federal court to protect the petitioner's constitutional rights. An examination of the record discloses that the federal constitution was not contravened and the action of the state courts did not result in a denial of due process of law to petitioner and appellant herein.

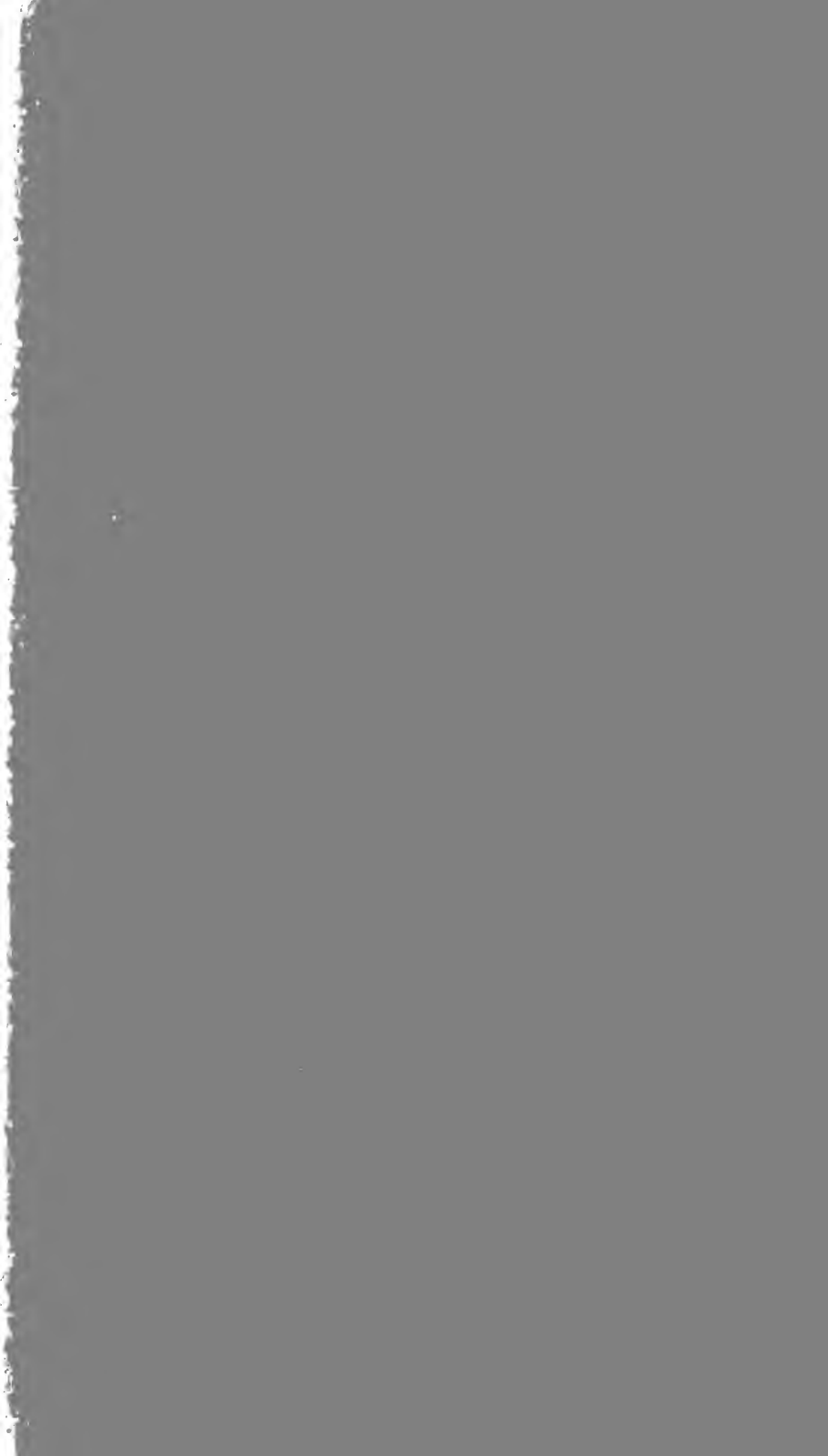
It is respectfully submitted that the judgment of the district court was correct and should be affirmed.

Respectfully submitted,

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APPENDIX

California Penal Code, Section 999a.

An application for a petition for a writ of prohibition, predicated upon the ground that the indictment was found without reasonable or probable cause or that the defendant had been committed on an information without reasonable or probable cause, must be filed in the appellate court within fifteen days after a motion made under Section 995 of this code to set aside the indictment on the ground that the defendant has been indicted without reasonable or probable cause or that the defendant had been committed on an information without reasonable or probable cause, has been denied by the trial court. A copy of such application shall be served upon the district attorney of the county in which the indictment is returned or the information is filed. The alternative writ shall not issue until five days after the service of notice upon the district attorney and until he has had an opportunity to appear before the appellate court and to indicate to the court the particulars in which the evidence is sufficient to sustain the indictment or commitment.

California Penal Code, Sec. 1008.

An indictment, accusation, or information may be amended by the district attorney without leave of court, at any time before the defendant pleads. The court may order its amendment for any defect or insufficiency, at any stage of the proceedings; and the trial shall continue as if it had been originally filed as amended, unless the substantial rights of the defendant would be prejudiced thereby, in which

event a reasonable continuance, not longer than the ends of justice require, may be granted. If the defect or insufficiency be one that can not be remedied by amendment, the proceeding shall be dismissed, but the defendant shall not be discharged if the court shall direct the filing of a new information or the submission of the case to the same or a new grand jury. An indictment or accusation can not be amended so as to change the offense charged, nor an information so as to charge an offense not shown by the evidence taken at the preliminary examination.

No. 13145

United States
Court of Appeals
For the Ninth Circuit.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

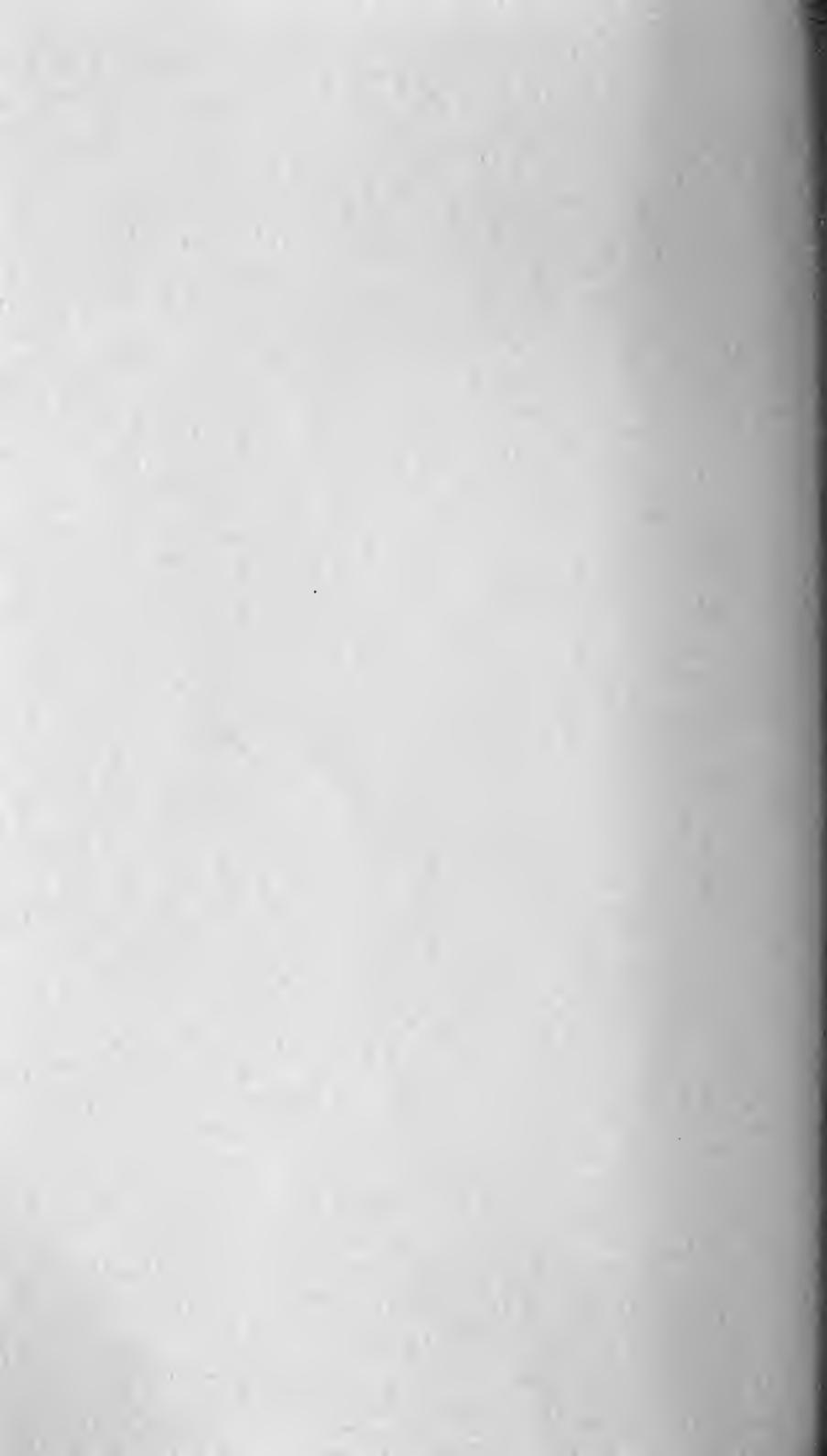
CECIL A. MILLER,
Respondent.

Transcript of Record

Petition to Review a Decision of
The Tax Court of the United States.

FILED

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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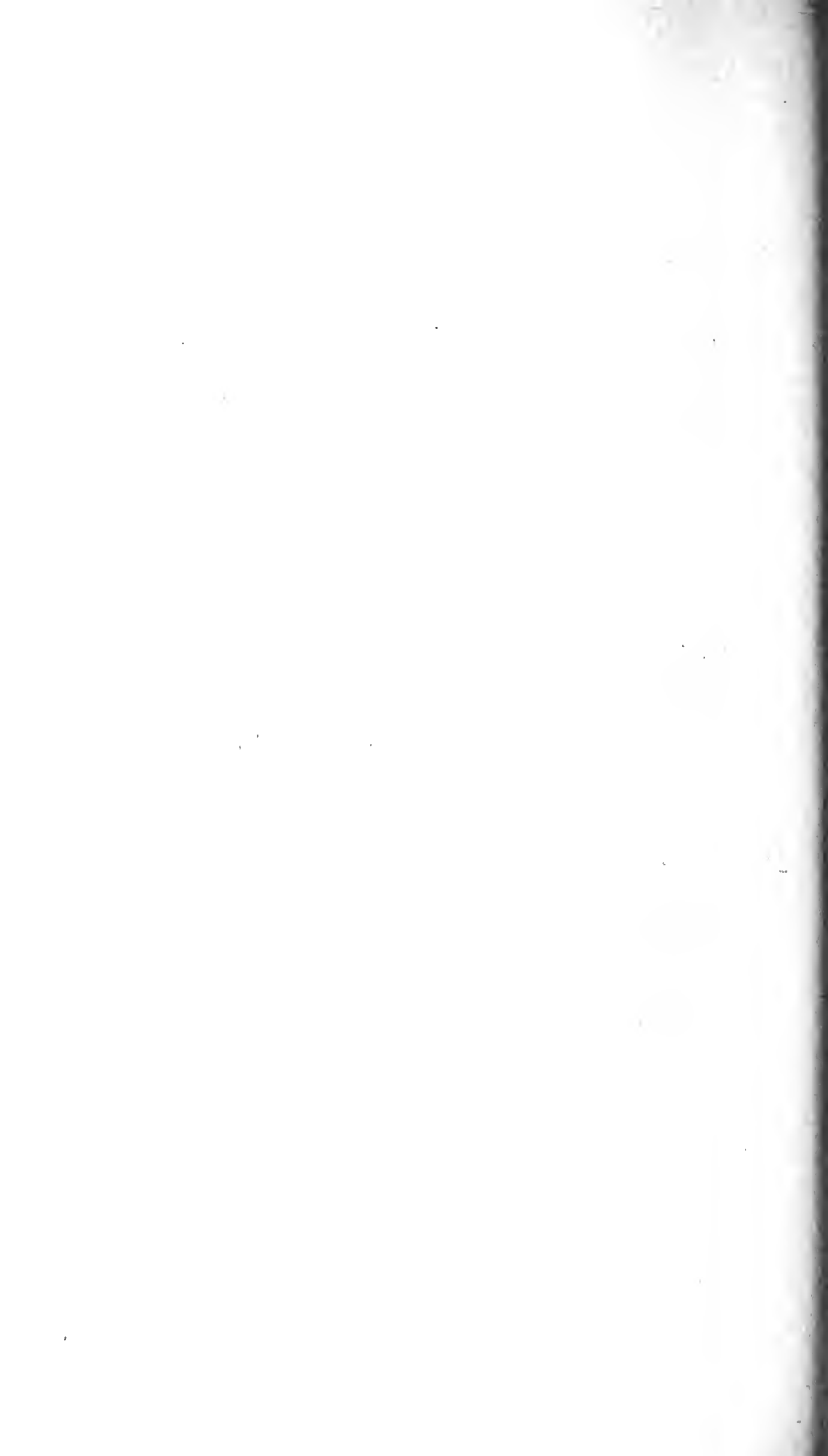
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Special Attorneys, Department of
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For Respondent, Cecil A. Miller:

GEORGE BOUCHARD,

650 South Spring St.,
Los Angeles 14, California.



In the Tax Court of the United States

Docket No. 23268

CECIL A. MILLER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Symbols IT:HSA:CONF) dated February 28th, 1949, and as a basis of her proceeding alleges as follows:

(1) That petitioner is an individual residing at 174 South Mango Street, Fontana, California. The return for the period here involved was filed with the Collector for the 6th District of California.

(2) The notice of deficiency was mailed to the petitioner on February 28th, 1949; a copy of the deficiency notice and so much of the statement contained therein as is material is attached hereto and marked Exhibit "A."

(3) The taxes in controversy are income taxes for the calendar year 1945 in the amount of \$1,207.00.

(4) The determination of tax set forth in said

notice of deficiency is based upon the following errors:

(a) The inclusion in income under Section 22(k) of the Internal Revenue Code of the sum of \$6,300.00 received by petitioner during the calendar year pursuant to a property settlement agreement entered into between petitioner and her husband on June 15, 1937.

(5 The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) On June 15, 1937, petitioner and her husband entered into a property settlement agreement; petitioner was granted an interlocutory judgment of divorce from her husband by the Superior Court of San Bernardino County, California, on August 23, 1937, and was granted by the same Court a final decree of divorce on August 25, 1938; the property settlement agreement was not intended to, and did not in fact, alter the relationship of the parties thereto except with regard to their property rights, and was not an incident to the divorce. Neither the interlocutory decree nor the final judgment of divorce made any provision for alimony or support for petitioner. The payments received by petitioner during 1945 under said agreement were not periodic payments in discharge of a legal obligation imposed upon or incurred by the husband because of the marital relationship, or imposed upon him by a Court decree divorcing the parties, or by a written instrument incident to such divorce, and accordingly, the payments received by petitioner

are not includable in her income for 1945 under Section 22(k) of the Internal Revenue Code, or any other section.

Wherefore, petitioner prays that this Court may hear the proceeding and determine that there is no deficiency in income tax for the calendar year 1945.

/s/ GEORGE BOUCHARD,
Counsel for Petitioner.

[Duly verified.]

EXHIBIT A

Treasury Department
Internal Revenue Service
Los Angeles 12, Calif.

IT: 331

Office of the Collector,
Sixth District of California.

In Replying Refer to IT:HSA:CONF,
Room 1731, Federal Bldg.

Feb. 28, 1949.

Cecil A. Miller,
174 So. Mango St.,
Fontana, California.

Serial No. 79570259-46 List

Dear Mr. Miller:

You are advised that the determination of your income tax liability for the taxable year 1945 discloses a deficiency of \$1,207.00 as shown by the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned. Within 90 days (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter you may file a petition with the Tax Court of the United States, Washington 25, D. C., for a redetermination of the deficiency.

If you consent to the proposed assessment, you are requested to sign the enclosed agreement (on page 4 of the enclosed statement) and notice and demand for payment will be sent you, or you may immediately forward remittance for the deficiency tax and interest now due to the Collector of Internal Revenue, Los Angeles 12, California.

Very truly yours,

GEO. J. SCHOENEMAN,
Commissioner of Internal
Revenue.

By /s/ HARRY C. WESTOVER,
Collector of Internal
Revenue.

JVD:1c

Enclosures:
Statement

STATEMENT

The statement which accompanied the Notice of Deficiency in so far as material to the issues set out in the Assignment of Error is as follows:

“Alimony payments of \$6300.00 are includible in income under Section 22 (k) of the Internal Revenue Code.”

Duly served May 25, 1949.

[Endorsed]: Filed May 24, 1949.

[Title of Tax Court and Cause.]

Docket No. 23268

ANSWER

The Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

(1) Admits the allegations contained in paragraph (1) of the petition.

(2) Admits that the notice of deficiency was mailed to the petitioner on February 28, 1949. Denies the remaining allegations of paragraph (2) of the petition.

(3) Admits the allegations contained in paragraph (3) of the petition.

(4) (a) Denies the allegations of error contained in subparagraph (a) of paragraph (4) of the petition.

(5) (a) Denies the allegations contained in subparagraph (a) of paragraph (5) of the petition.

(6) Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

[Endorsed]: Filed July 11, 1949.

[Title of Tax Court and Cause.]

Docket No. 24478

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Symbols IT:HSA:JVD) dated July 13, 1949, and as a basis of her proceeding alleges as follows:

(1) That petitioner is an individual residing at 174 South Mango Street, Fontana, California. The return for the period here involved was filed with the Collector for the 6th District of California.

(2) The notice of deficiency was mailed to the

petitioner on July 13, 1949; a copy of the deficiency notice and so much of the statement contained therein as is material is attached hereto and marked Exhibit "A."

(3) The taxes in controversy are income taxes for the calendar year 1946 in the amount of \$995.60.

(4) The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The inclusion in income under Section 22(k) of the Internal Revenue Code of the sum of \$6,300.00 received by petitioner during the calendar year pursuant to a property agreement entered into between petitioner and her husband on June 15, 1937.

(5) The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) On June 15, 1937, petitioner and her husband entered into a property settlement agreement; petitioner was granted an interlocutory judgment of divorce from her husband by the Superior Court of San Bernardino County, California, on August 23, 1937, and was granted by the same Court a final decree of divorce on August 25, 1938; the property settlement agreement was not intended to, and did not in fact, alter the relationship of the parties thereto except with regard to their property rights, and was not an incident to the divorce. Neither the interlocutory decree nor the final judgment of divorce made any provision for alimony or support for petitioner. The payments received by

petitioner during 1946 under said agreement were not periodic payments in discharge of a legal obligation imposed upon or incurred by the husband because of the marital relationship, or imposed upon him by a Court decree divorcing the parties, or by a written instrument incident to such divorce, and accordingly, the payments received by petitioner are not includable in her income for 1946 under Section 22(k) of the Internal Revenue Code, or any other section.

Wherefore, petitioner prays that this Court may hear the proceeding and determine that there is no deficiency in income tax for the calendar year 1946.

/s/ GEORGE BOUCHARD,
Counsel for Petitioner.

[Duly verified.]

EXHIBIT A

Treasury Department
Internal Revenue Service
Los Angeles 12, California

Office of the Collector,
Sixth District of California.

In replying refer to IT:HSA:JVD,
Room 1731 Federal Building.

July 13, 1949.

Mrs. Cecil Anabel Miller,
174 So. Mango St.,
Fontana, California.

Serial No. 85611405-47 List

Dear Mrs. Miller:

On April 14, 1949, you were notified of an apparent deficiency in your income tax for 1946 and advised of your privilege to file a protest within 30 days from that date. No protest has been received in this office.

The correct amount of the deficiency has been finally determined to be \$995.60 (see attached explanatory statement). Within 90 days (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter you may file a petition with the Tax Court of the United States, Washington 25, D. C., for a redetermination of the deficiency.

If you consent to the proposed assessment, you are requested to sign the enclosed agreement (on

page 4 of the enclosed statement) and notice and demand for payment will be sent you, or you may immediately forward remittance for the deficiency tax and interest now due to the Collector of Internal Revenue, Los Angeles 12, California.

Very truly yours,

GEO. J. SCHOENEMAN,
Commissioner of
Internal Revenue.

By /s/ HARRY C. WESTOVER,
Collector of Internal Revenue.

JVD:lc

Enclosures: Statement.

STATEMENT

The statement which accompanied the Notice of Deficiency in so far as material to the issues set out in the Assignment of Error is as follows:

“Alimony payments of \$6300.00 are includible in income under Section 22 (k) of the Internal Revenue Code.”

[Served Aug. 11, 1949.]

[Endorsed]: Aug. 10, 1949.

[Title of Tax Court and Cause.]

Docket No. 24478

ANSWER

The Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

(1) and (2) Admits the allegations contained in paragraphs (1) and (2) of the petition.

(3) Admits that the taxes in controversy are income taxes for the calendar year 1946; denies the remaining allegations contained in paragraph (3) of the petition.

(4)(a) Denies the allegations of error contained in paragraph (4)(a) of the petition.

(5)(a) Admits that at some time prior to the taxable year involved herein (the exact time is not known to respondent) the petitioner and her husband Jared H. Miller separated and were divorced by judicial decree (a copy of which is not attached to the petition or furnished to respondent, so as to fully advise him of its contents); that prior to their divorce the Millers entered into an agreement, so respondent is informed, and believes, settling their property rights and providing for payments of alimony to the petitioner; that pursuant to the said agreement, the petitioner received during the year 1946, \$6,300.00, which amount the respondent determined to be income to the petitioner on au-

thority of Sec. 22(k) of the Internal Revenue Code, and included the same in her income in the computation upon which the deficiency notice is based. Respondent denies all allegations of paragraph (5)(a) of the petition not just above admitted.

(6) Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

[Endorsed]: Filed Sept. 12, 1949.

[Title of Tax Court and Causes.]

Docket Nos. 23268 and 24478

OFFICIAL REPORT OF PROCEEDINGS

The Court: The next case is Cecil S. Miller, Docket Nos. 23268 and 24478.

I might say that I have read the pleadings and that I know what the case is all about.

You are claiming that these payments which Mrs. Miller received are not taxable under 23G and K and 22U.

Mr. Bouchard: I had a fine opening statement that I am not going to make.

The Court: I think also you are taking that position because you claim the agreement was not entered in the divorce, but was something separate from it.

Mr. Bouchard: Yes.

Judge McCoy, would you take the stand please.

Whereupon,

PHILBRICK McCOY

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Witness: Philbrick McCoy, Judge of the Superior Court, Los Angeles County, Los Angeles 12.

Mr. Bouchard: There are two cases on the docket, 23268 and 22478, and I take it there has been no formal motion made to consolidate the cases.

The Court: They may be consolidated. [4*]

Mr. Bouchard: For the sake of the record, I have Mrs. Miller in court and she waives any claim of privilege you may have, Judge McCoy, as her former attorney, in testifying.

Direct Examination

By Mr. Bouchard:

Q. Are you acquainted with Mrs. Cecil Miller, the Petitioner in this case? A. Yes, sir.

Q. Did she ever consult you professionally?

A. Yes.

Q. Do you remember when?

A. Sometime about the middle of October in 1936.

Q. For what purpose?

* Page numbering appearing at top of page of original Reporter's Transcript of Record.

(Testimony of Philbrick McCoy.)

A. She had received a communication from her husband, Dr. Jared H. Miller, with respect to a proposed property settlement agreement and she employed me to advise her with respect to that matter and to conduct the subsequent negotiations.

Q. And who represented Dr. Miller?

A. At that time an attorney in Detroit named Wheat and locally by Bernard Potter, Senior.

Q. Of Los Angeles? A. Of Los Angeles.

Q. And during what period of time, Judge McCoy, did you [5] conduct negotiations looking toward this property settlement agreement?

A. Almost continuously from that date—I think it was October 31 that Mrs. Miller first retained me until the property settlement agreement was signed sometime in June of 1947, as I recall the date.

Q. Wasn't it '37? A. '37, excuse me.

Q. Were all of the negotiations in connection with that property settlement carried on by you with the attorneys for Mr. Miller? A. Yes.

Q. You never had any direct negotiation of any kind with him?

A. Not that I recall until the time the agreement was signed and in some other matters thereafter.

Q. Now, in connection with that agreement, who made the first proposal? A. Dr. Miller.

Q. Do you recall what his offer was?

A. In substance that he would provide for Mrs.

(Testimony of Philbrick McCoy.)

Miller an income of approximately \$400 a month and would give to her outright, he to maintain, what became known as the Fontana property; that is a residence in Fontana, California. [6]

Q. Was that offer accepted? A. No.

Q. Did you make a counter proposal?

A. Yes, sir.

Q. Do you recall what it was?

A. Substantially that Mrs. Miller—Dr. Miller then being a legal resident of Michigan—was entitled to her one-third—equivalent of a one-third dower interest under the laws of Michigan, and she demanded assignment of that one-third dower interest in his properties; and in addition thereto an income assured to her of approximately six thousand dollars a year.

Q. The properties in question owned by Dr. Miller were Michigan mining properties, were they not? A. Yes.

Q. And stock in Michigan mining corporations?

A. That is correct.

Q. Did Dr. Miller's attorney give you any favorable consideration to that proposal, if you know?

A. They considered it and later rejected it.

Q. Do you know why Dr. Miller rejected that proposal?

A. I was informed in connection with the negotiations that he rejected it because he did not desire to have Mrs. Miller an owner of interest, any proportional interest, in the mining properties, the

(Testimony of Philbrick McCoy.)

theory being in his mind, the idea [7] being in his mind, that it would embarrass him with his associates to have Mrs. Miller become an owner.

Q. Did he then make a counterproposal?

A. He then made a proposal, the substance of which, as I recall it, came along about January or February.

Q. Of 1936?

A. 1937. He was to give her an income of something like six thousand dollars, which she had demanded in lieu of her interest in these mines, these mining properties, and the stocks and other things that he owned.

He said in effect, I will keep the mining interests, I will keep what I have got, but I will assure you of six thousand or sixty-four hundred dollars a year, I forget what the exact figure was.

Q. Is that the figure that is in the property settlement agreement? A. Yes.

In addition thereto he proposed to give her the Fontana property as her own, and to make certain provisions—the details of which I have forgotten—for the support of her son, then a minor. I think he was about 18 or 19 at the time, as I recall it. This was to be done in the event of Mrs. Miller's death, and likewise to make certain provisions in his will for the support of Mrs. Miller's mother, whose name I have forgotten. [8]

Q. Now, those financial arrangements in substance which you have testified to were the financial

(Testimony of Philbrick McCoy.)

arrangements that were ultimately incorporated in the property settlement executed in June of 1937, is that correct? A. Substantially, yes.

Q. And those agreements were reached in about January or February of 1937?

A. As I recall it.

Q. Why did it take so much time to get the settlement in shape between January and the time of the execution in June?

A. The personal property. Dr. Miller had acquired in his travels—their travels—I would venture to say, as I recall the situation, a matter of five to six hundred curios, such as rugs, vases, and certain things of that type and the distribution or the division of those items, ultimately reflected in schedules A and B, was the basis for the time consuming element for the next four or five months.

Q. Now, Judge, do you recall when the division of that personal property was finally agreed upon and the terms of the ultimate agreement reached?

A. Sometime in May of '37, as I recall it.

Q. Why was it that the agreement was not signed until June 15th of '37?

A. Because about that time Mr. Potter, the [9] attorney, the local attorney, the Los Angeles attorney, for Dr. Miller informed me that he then anticipated Dr. Miller's arrival in California sometime in the near future.

Q. Now, Judge, at the time that Mrs. Miller employed you, did she say anything to you about her desire of wanting to secure a divorce?

(Testimony of Philbrick McCoy.)

A. Yes, she said she didn't want one.

Q. And that was when she came to you in October of 1936? A. That is right.

Q. Did either Dr. Miller or his attorneys ever indicate to you that Dr. Miller wanted a divorce and that this property agreement was contingent upon Mrs. Miller getting one? A. No.

Q. Did they indicate, either Dr. Miller or his attorneys, that the making of the property agreement was a part of a contemplated divorce action?

A. Not at all.

Q. Now——

A. Let me qualify that. Having in mind that the agreement was later approved by the Superior Court of Santa Barbara County—I am not quite sure because I haven't read the agreement for some years, but it may have contained the customary clause that if, as and when, either party might [10] obtain a divorce it could be submitted to the court for approval.

Q. I will say to you, Judge, that it does contain that provision. A. Yes.

Q. But as far as the execution of the agreement was concerned, it was never involved in any way with the contemplated divorce action?

A. None whatsoever.

Q. Nor were you ever advised by either Dr. Miller or either of his attorneys that it was contemplated that it would be signed only in the event of a divorce?

(Testimony of Philbrick McCoy.)

A. There was no such suggestion.

Q. Now, Mrs. Miller did ultimately file suit for a divorce shortly after the property settlement was signed, did she not?

A. Sometime late in June, as I recall it, of 1937.

Q. When did Mrs. Miller first inform you that she thought she would file an action for divorce?

A. It might have been late in April and it might have been early in May of 1937, somewhere along in there, but not before that.

Q. Did she give you any reason for her change of mind as to why she would file such an action?

A. Yes. [11]

Q. What reason did she give?

A. Mrs. Miller at that time was living and had for several years—I have forgotten how many—in Fontana, California, San Bernardino County, which is some eighteen miles from here, and at that time, 1936, it was relatively a small town. Like all small towns everybody knew each other's business, and Mrs. Miller advised me that any number of her friends and acquaintances were constantly asking her when Dr. Miller was coming home, and in order to avoid that embarrassment and to terminate any discussion among her friends and acquaintances in Fontana, she said she had decided to get a divorce. That is substantially the statement she made.

Q. I think the record will show, Judge McCoy, that this action was started on the 23rd day of June, 1937, and the property settlement was signed June 15, 1937.

(Testimony of Philbrick McCoy.)

Why was this divorce action started so soon after the property settlement was executed?

A. As a matter of convenience. After Mrs. Miller reached the conclusion I have just stated to proceed with the divorce action, and Mr. Potter having informed me that Dr. Miller's presence was expected in Los Angeles shortly, Mrs. Miller concluded on my advice to file the action forthwith, that is, relatively speaking, in order that personal service of the communication and complaint might be had on Dr. Miller, thus requiring him to plead within a matter of ten days before [12] the date of service and thereby avoid service of summons by publication, which would have entailed a matter of some 90 days' delay.

Q. In other words, you started to obtain service in California?

A. That is right, and in order to serve him when he was here in connection with the signing of the agreement.

Q. Now, you obtained both the interlocutory and final decrees for Mrs. Miller?

A. That is right.

Q. It was an uncontested case?

A. Uncontested.

Q. Dr. Miller did not appear?

A. Did not appear or answer.

Q. You are familiar, are you not, Judge, with the supplemental agreement that was made April 19, 1938, between Mrs. Miller and her former husband, I think you prepared it, did you not?

(Testimony of Philbrick McCoy.)

A. Yes, that had to do with certain changes, as I recall it, in the arrangement made with respect to the Fontana property.

Q. Now, was that supplemental agreement of April, 1938, ever submitted to the clerk for approval? A. No.

Q. As I understand your testimony, all of [13] the financial terms of the property settlement agreement were agreed upon between you and counsel for Mr. Miller back in January or February of 1937, is that right? A. That is right.

Q. And nothing was ever said to you by Mrs. Miller about a divorce until some time in the latter part of April or May of 1937?

A. Thereabouts.

Q. And neither Dr. Miller nor any of his attorneys ever indicated to you that there was any connection between the property settlement agreement and the divorce action?

A. None whatsoever.

Mr. Bouchard: You may cross-examine.

Mr. Flynn: Judge McCoy, I only have a few questions and I will try to make them very brief.

Cross-Examination

By Mr. Flynn:

Q. To refresh you recollecton, Judge McCoy, I show you what purports to be a letter on your stationery, dated——

(Testimony of Philbrick McCoy.)

Mr. Bouchard: May I see it?

Mr. Flynn: Yes.

It is dated July 13, 1937.

The Witness: Yes.

Q. (By Mr. Flynn): Judge McCoy, did you have any corespondence with [14] the attorneys for Dr. Miller prior to the granting of the divorce or the filing of the divorce in which you indicated to the other side that you would file a default for Dr. Miller in the divorce case?

A. That I would file a default for him?

Q. I should say that you would enter his default in the case.

A. I may very well have, I don't recall it, but I may very well have, because it would be a normal practice that once a defendant having been served and fails to respond to the summons, when the time is up I would enter his default. I have done it a thousand times.

Q. You had an agreement, did you not, Judge McCoy, with the other side in that case that you would receive attorney fees from Dr. Miller?

A. Yes, about a thousand dollars, I think, if I remember the figure correctly.

Q. Then you knew at that time it would not be a contested divorce?

A. The thousand dollars was for the property settlement agreement. Once the divorce action came along I had a further agreement, and I forget the fee he did pay me, but he did pay me a fee. When

(Testimony of Philbrick McCoy.)

that agreement was entered into, I couldn't begin to tell you, but I had such an agreement, yes. [15]

Q. Just prior to the filing of the divorce complaint, isn't it true that the agreement and the divorce were considered together in correspondence principally?

A. Quite likely, because by this time, if I remember correctly, I had informed Dr. Miller's attorney—I had referred in a letter as early as sometime in the latter part of April, that a divorce was in the wind, but by this time the property settlement was coming up to an end, and Mrs. Miller had advised me, as I just indicated, that she had concluded to get a divorce. Bernard Potter and I would stand on the street corner at Fifth and Spring any number of times during the lunch hour when we would meet and chew the fat about it, and then we would reduce the matters to correspondence. I don't doubt but that many times I referred to a divorce in the same letter that I was writing about the property settlement. I didn't keep two separate files in this respect.

Q. Weren't you at one time advised by Attorney Potter for Dr. Miller that unless Mrs. Miller signed the agreement that Dr. Miller would not go through with the divorce as planned?

A. That Dr. Miller wouldn't go through with the divorce? Dr. Miller had nothing to do with it. If he wanted to answer it and contest it, he might, but I don't recall any such conversation as [16] that.

(Testimony of Philbrick McCoy.)

Q. Judge McCoy, I show you what purports to be a certified copy of the interlocutory judgment in the case of Miller versus Miller in the State Court of California, County of San Bernardino, and ask you if that is a copy of the interlocutory decree which was entered in that case?

A. Not having read it, I wouldn't testify, but seeing the clerk's certification on there, I would say yes.

Q. Judge, was this decree prepared around the same time that the agreement was prepared?

A. No, that decree was prepared either a couple of days before or a couple of days after the case was tried on the default in San Bernardino County. I may have had it with me when I went over there, and then again I may have sent it over. My recollection is that I did not send over the decree until after the trial.

Q. I show you what purports to be a certified copy of the complaint in the case——

A. It appears to be. That is my signature.

Q. Is that your signature there? A. Yes.

Q. About when did you prepare this complaint, Judge McCoy, do you remember?

A. A week or ten days possibly before it was filed.

Q. About a week or ten days before it was filed?

A. In sufficient time for Mrs. Miller to have it signed [17] the next time she came in to Los Angeles from Fontana. I would have to check my files to see what date it was.

(Testimony of Philbrick McCoy.)

Let me see it a minute. It is verified June 22, 1937, and it purports to have been filed—was filed June 23. The chances are ten to one that I prepared that between the 15th of June, the date of the property settlement agreement, and the date it was verified.

Q. Now, Judge McCoy, I show you the interlocutory judgment which we were talking about a minute ago, and ask you if it isn't true that specifically as it pertains to paragraphs 2 and 3 of said document, that you drafted this interlocutory document?

A. I drafted the whole thing. My secretary typed it.

Q. And where in the second paragraph it refers to the plaintiff being entitled to a divorce and so forth, and in the third paragraph where it refers to the fact that a property settlement agreement dated June 15, 1937, was entered into between Jared H. Miller, above-named defendant, and Cecil S. Miller, that you also drafted those two paragraphs when you drafted the interlocutory judgment?

A. Yes, I drafted that. It is common practice in this state to incorporate in a property settlement agreement the language to the effect that this is not an agreement for a divorce, but if a divorce is sought or granted to either party, no divorce being pending, or if it is a fact that the [18] divorce action is pending, this agreement may be submitted to the court and may be approved, and that is pre-

(Testimony of Philbrick McCoy.)

cisely what was done in this case and in the complaint which was filed in this action if my memory serves me correctly.

In order that I could obtain the relief which I sought, I recited in paragraph 4 of the complaint: "The plaintiff and defendant have entered into a property settlement agreement for the care and maintenance of the plaintiff during the rest of her natural life, dated June 15, 1937, said agreement is acceptable to the plaintiff and will be submitted to the entitled court at the hearing of this action for approval of the court. Whereafter, the plaintiff prays that the bonds of matrimony now in existence between the defendant and herself be dissolved and that the property settlement agreement between the parties of this action dated June 15, 1937, be ratified and approved. The plaintiff may have her costs and such further equitable relief as may be just and proper."

The original was submitted to the court on the date the case was tried, and it was approved, and the decree was then prepared as you have just indicated.

Q. Judge McCoy, I have just one or two more questions.

After the agreement was signed and after the divorce decree was entered, within the years following that, did you at any time write a letter to Mr. Bernard Potter [19] regarding the tax consequence of that agreement?

(Testimony of Philbrick McCoy.)

I show you this letter to refresh your recollection.

A. That is my signature. Yes, I wrote that letter February 12, 1943, after the point had been raised notwithstanding what had transpired in the past that Mrs. Miller was going to have to pay income tax on what she received from Dr. Miller.

Q. Judge McCoy, on February 12, 1943, it was your opinion on that date that Mrs. Miller under the agreement and under the circumstances at the time the agreement was executed was liable for the tax on the payments she received under the agreement?

Mr. Bouchard: That calls for a conclusion and it is immaterial.

The Witness: I should say in the first place that it wasn't my opinion. In the second place, I didn't have an opinion because I by no means am an expert on income tax matters. Consequently, I didn't press that too much.

Mr. Flynn: No further questions. Thank you very much, Judge McCoy.

The Court: Mr. Bouchard, do you have any further questions?

Mr. Bouchard: No further questions.

The Court: You are excused.

(Witness excused.) [20]

Whereupon,

CECIL MILLER

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: Cecil Miller, 174 South Mango, Fontana.

Direct Examination

By Mr. Bouchard:

Q. Now, Mrs. Miller, I want you to speak up loudly so the court can hear what you have to say. Will you do that, please? A. Yes.

Mr. Bouchard: Your Honor, I want to offer three or four documents into evidence. Counsel and I have stipulated that these are correct copies of the originals.

I want to offer as the first exhibit the property settlement agreement between Jared H. Miller and Cecil S. Miller dated June 15, 1937.

Mr. Flynn: No objection. My understanding is that that is the same agreement that I examined in the office.

Mr. Bouchard: That is so, and that is the only agreement that I have.

The Court: Admitted. [21]

The Clerk: Exhibit 1.

(The document above referred to was marked Petitioner's Exhibit No. 1 and received in evidence.)

(Testimony of Cecil Miller.)

PETITIONER'S EXHIBIT No. 1

Property Settlement Agreement Between Jared H.
Miller and Cecil S. Miller

This agreement made and entered into this 15th day of June, 1937, by and between Jared H. Miller, of Fontana, California, hereinafter called the First Party, and Cecil S. Miller, of the same place, hereinafter called the Second Party;

Witnesseth:

Whereas, the said parties were married on or about the twenty-fourth day of December, 1921, in the City of Gardena, County of Los Angeles, State of California, and ever since said date have been and now are husband and wife; and

Whereas, the parties hereto are desirous of entering into an agreement settling and adjusting their property rights of every kind, nature and description in any property belonging to them, or either of them, and establishing their mutual rights in such property;

Now, therefore, said parties for the considerations hereinafter particularly set forth, and their mutual agreements hereinafter contained, do hereby stipulate and agree as follows:

First. (1) The First party, Jared H. Miller, is now the true and lawful owner of the following described property, both real and personal, other

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 1—(Continued)

than the personal property, described in Schedules A and B attached hereto, as his sole and separate property, to wit:

1. Fontana Property, which is more particularly described as follows:

The East Two and five hundred seventy-five thousandths (E.2.575) acres of the North half of the East half (N. $\frac{1}{2}$ or E. $\frac{1}{2}$) of Farm Lot Six hundred fifty-seven (657), as numbered and delineated on map showing subdivision of lands belonging to Semi-Tropic Land and Water Company, recorded in Book 11 of Maps at Page 12, records of San Bernardino County. The areas and distances of the above-described real property are computed to the centers of all adjoining streets and roads as shown on said map.

2. Big Bear Lease, which is more particularly described as follows:

Term Lease of Lot 309 from United States Government, on North side of Big Bear Lake, San Bernardino County, California.

3. Undivided $\frac{2}{5}$ ths interest in Morris Mine, which is more particularly described as follows:

Lease No. 9—N.W. $\frac{1}{4}$ of S.E. $\frac{1}{4}$ of Section One, Township 47 N., Range 28 West.

Lease No. 24—E. $\frac{1}{2}$ of S.W. $\frac{1}{4}$ Section 1.

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 1—(Continued)

Lease No. 25—Lot 2 and the S.W. $\frac{1}{4}$ of S.W. $\frac{1}{4}$, Section 1.

Lease No. 26—S.E. $\frac{1}{4}$ of S.E. $\frac{1}{4}$ and all that part of Lot 3, lying south of the center line of Section 2. All situated in Section 2, Township 47 N., Range 28 West.

Lease No. 27—All of Lot 4 of Section 2, lying South of center line of said section and all their right, title and interest in the S.W. $\frac{1}{4}$ of S.E. $\frac{1}{4}$ of Section 2.

Lease No. 28—N.E. $\frac{1}{4}$ of S.W. $\frac{1}{4}$, Section 2, Township 47 North, Range 28 West.

All situate in the State of Michigan.

4. All other real estate in the State of Michigan, title to which is in the name of First Party.

5. Stock in Barnes Land Company, a Michigan corporation, standing in name of First Party.

6. All securities of Lake Superior Land Company, a Michigan corporation whose charter has expired, and Emery Land Company, a Michigan corporation, standing in the name of First Party or held in his possession, or otherwise owned by him.

7. All other cash, bank accounts and securities registered or standing in the name of First Party or held by him, or otherwise purporting to be owned by him.

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 1—(Continued)

(2) The Second Party, Cecil S. Miller, is not now the true and lawful owner of any property, real or personal, other than the personal property described in Schedules A and B attached hereto, as her sole and separate property, and other than cash on hand and bank accounts in the name of the Second Party.

(3) First and Second Parties are not now jointly the lawful owners of any personal or other property, as joint tenants or as tenants in common.

Second. (1) Coincident with the execution of this agreement, the First Party by appropriate instrument, will convey to the Second Party a life estate in the real property situated at Fontana, San Bernardino County, California, more particularly described in Paragraph First (1) as the Fontana Property, and the First Party agrees that the Second Party shall thereafter have exclusive possession and control of said property during the remainder of her natural life, to be used, however, by her and the members of her immediate family as a home, and not to be rented by her or otherwise used for profit or gain.

(2) The First Party will pay all taxes that have accrued and that may hereafter accrue and become a lien on said property, and will pay the balance of the principal of the purchase price of said property as it may fall due, together with the interest

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 1—(Continued)

thereon, now secured by a mortgage which is a lien against the said property. The First Party will also secure and keep in force adequate insurance against loss of the buildings on said property by fire. Second Party, during her lifetime, will pay all the expenses for the ordinary care and upkeep of said property, and will not incur any obligations for extraordinary expenses without the written approval of First Party. First Party may enter and inspect the said premises at reasonable times, not in person, however, but by an agent duly authorized by him and approved by Second Party.

(3) Upon demand by Second Party, but not prior to November 10, 1937, First Party will expend the sum of \$750.00 for the improvement of said real estate at Fontana, California, particularly in the planting and replanting of said land, and the completion of the construction of a library in the part of the premises originally designated as a garage, and the furnishings thereof; all, however, under the direction of First Party. The First Party may expend such other sums for the improvement of said real estate from time to time as he may desire, with the approval of the Second Party as to the purpose thereof so long as she shall occupy said property as her home.

(4) At any time during the lifetime of the Second Party, and with the consent of the parties hereto, First Party will sell or exchange the real

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 1—(Continued)

property at Fontana, California, hereinabove more particularly described, and with the proceeds of such sale, together with such additional amounts as said First Party may deem proper, or upon such exchange, will purchase other property in Fontana, California, suitable for residence purposes, and the Second Party shall have a life estate in any such property so purchased, subject to the terms and conditions herein set forth with respect to her life estate in said property at Fontana, California, as hereinabove set forth.

Third. (1) First Party will pay Second Party the sum of \$6,300.00 per year, so long as Second Party shall live, payable at the rate of \$1,200.00 per quarter on the tenth day of the months of February, May, August and November of each year, commencing the tenth day of August, 1937, and \$1,250.00 on November 15, 1937, and \$1,500.00 on November fifteenth of each year thereafter, commencing November 15, 1938; provided, however, that the total payments to Second Party in any year shall not exceed fifty per cent (50%) of First Party's net income for the previous calendar year. Any reductions in the payments to Second Party by reason of this provision shall be ratably apportioned among the instalments above provided.

(2) For the purposes of this agreement, "net income" means "net income" as defined by section

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 1—(Continued)

21 of the Revenue Act of 1936 relating to the payment of income taxes to the United States, less Federal income tax on the net income of the First Party for the calendar year for which such net income is computed; provided, however, that for the purposes of this agreement capital gains and losses, as defined by the Revenue Act of 1936, shall not be considered in computing such net income; and provided, further, that all the ordinary and necessary business expenses of First Party incurred in connection with the ownership and operation of the mining properties owned by him in the State of Michigan or elsewhere, or in connection with the ownership of securities in corporations or associations owning or operating mining properties in the State of Michigan or elsewhere, shall be considered as deductions in computing such net income, when claimed as such by First Party under the provisions of the Revenue Act of 1936, whether or not such deductions are ultimately allowed by the Commissioner of Internal Revenue.

(3) The amount or amounts of any reduction in payments made to Second Party below \$6,300.00 per year, pursuant to this agreement, however, shall be repaid to Second Party out of Fifty per cent of the excess over \$12,000.00 per annum of the next payments received by First Party from the operation of such mining properties and from such dividends and interest in such corporations or as-

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 1—(Continued)

sociations owning or operating such mining properties.

(4) It is contemplated that the annual payments of \$1500.00, payable on November fifteenth each year, shall be placed and held by Second Party in a special trust or fund, revocable or irrevocable as she may decide, in order to provide a fund for the ordinary care and upkeep of the Fontana property as herein provided, and to provide for her a reserve for unexpected emergencies; provided, however, that there shall be no liability on the part of the Second Party for her failure to maintain such special fund, and her failure to do so shall not affect her right to continue to receive the amounts hereinabove set forth.

(5) If the Second Party survives the First Party, then upon his death the amounts herein provided to be paid to the Second Party shall be paid to her as herein provided by the executors of the estate of the First Party until such time as the residue of his estate may be distributed to this testamentary trustees. Upon the distribution of the residue of said estate to the testamentary trustees thereof, if the fair value of such residue shall equal or exceed the sum of \$150,000.00, Second Party will accept an agreement by the testamentary trustees of the residue of said estate directly assuming the obligations of the First Party under this agreement, and upon acceptance of such agreement from

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 1—(Continued)

said testamentary trustees, will consent to the discharge of the executors of the estate of the First Party and to the closing of said estate and the transfer of the residue thereof to said testamentary trustees. If the fair value of the residue of the estate of the First Party distributed to the testamentary trustees is less than \$150,000.00, the amount of the payments to be made to Second Party shall be reduced in the same proportion to \$6,300.00 as the fair value of such residue at the time of such distribution bears to \$150,000.00, and Second Party will accept an agreement by the testamentary trustees to assume such obligation and will consent to the closing of the estate as aforesaid.

(6) First Party will not, during his lifetime, sell, mortgage or otherwise dispose of an undivided one-fifth ($1/5$ th) of the Morris Mine as described above, being one-half ($1/2$) of his undivided two-fifths ($2/5$ ths) interest therein, without the consent of Second Party or without providing that the proceeds of such sale or disposition shall stand subject to the same restraint on the power of First Party to alienate the same, or without providing security for the performance of this agreement by depositing with trustees property of the fair value of \$150,000.00.

(7) Except as hereinabove provided, nothing in this agreement contained shall constitute a lien upon any of the property or estate of First Party or

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 1—(Continued)

upon any royalties, payments, interest, dividends or other income accruing to First Party.

Fourth. (1) In the event of the death of Second Party prior to the death of First Party, First Party agrees to pay to the son of Second Party, Myron A. Sheward, \$100.00 per month for his lifetime, or until the death of the First Party, he, the said Myron A. Sheward, then to receive such amounts as First Party may provide for in his Will.

(2) In the event of the death of the Second Party prior to the death of the First Party, First Party agrees to pay to Mrs. B. A. Doggett, mother of the Second Party, should she then be living, the sum of \$35.00 per month for her lifetime, or until the death of the First Party, she, the said Mrs. B. A. Doggett, then to receive such amounts as First Party may provide in his Will.

Fifth (1) The Second Party, coincident with the execution of this agreement, will by an appropriate instrument, convey any right, title or interest she may now have in or to the property or cabin belonging to the First Party at Bear Lake, California, located on United States Government Lease No. 309, and in or to said lease; and the First Party, coincident herewith, will, by appropriate instrument, transfer and convey to Second Party all right, title and interest he may have in

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 1—(Continued)
and to his life membership in the Peter Pan Woodland Club.

(2) The personal property, including the household furniture, furnishings and fixtures owned by the parties hereto, on the execution of this agreement, shall be distributed between the parties hereto in accordance with the Schedules hereto annexed. Thereupon, the property described in Schedule A shall be and become the sole and separate property of the First Party, free and clear of all present or future claims of the Second Party, and the property described in Schedule B shall be and become the sole and separate property of the Second Party, free and clear of all present or future claims of the First Party. First Party agrees that he will remove all his separate property as in Schedule A described from the residence at Fontana, California, and that Second Party will not hereafter be charged with the custody or care of any part thereof.

Sixth (1) This agreement shall not alter the relations of the parties hereto except with regard to their property rights; provided, however, that in the event that either party hereto shall obtain a divorce from the other, this agreement may be submitted to the court in which said divorce is obtained for approval.

(2) This agreement is a full, complete and final

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 1—(Continued)

settlement of all the property rights of the parties hereto, and neither party hereto, either as heir at law of the other party or otherwise, shall make further claim on any kind whatsoever upon the other, nor for any other or further property than the property received by the parties hereto, respectively, under the terms of this agreement.

(3) Except as herein provided, all claims of either party against the other, in the event of the death of either party hereto, as surviving husband or wife, respectively, and all right to administer or apply for letters of administration upon the estate of the other are hereby expressly waived and relinquished.

(4) The property received or retained by each of the parties hereto, respectively, is received, and the agreements herein contained are made, by each of the parties hereto in lieu of all rights which the law would give the other as husband or wife, or as a surviving husband or wife, and except as herein provided, the property so received or retained and so declared to be the property of the respective parties hereto shall be and forever remain the sole and separate property of such parties, each party having full power to sell, assign and deal with the same as though each of the parties was unmarried.

(5) Each party hereto further agrees to sign,

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 1—(Continued)

acknowledge, execute and deliver to the other party, when requested so to do, any and all documents and papers which may be necessary or convenient or may be required by any purchaser to enable each of the parties hereto to receive, sell or dispose of the property acquired or received or to be held by each party under the terms of this agreement, or of other property hereinabove declared to be the property of said parties, or either of them. . .

(6) Each of said parties has been separately represented and fully advised by their own attorneys as to their rights and liabilities and as to the nature, extent and force of this agreement.

(7) This agreement shall bind the executors, administrators, representatives, heirs and assigns of the parties hereto, and the testamentary trustees of the estate and Will of First Party.

In Witness Whereof, the parties hereto have signed this agreement the day and year first hereinabove written.

/s/ JARED H. MILLER,
JARED H. MILLER,
First Party.

/s/ CECIL S. MILLER,
CECIL S. MILLER,
Second Party.

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 1—(Continued)

SCHEDULES "A" AND "B"

[Schedule "A" is a list of articles of personal property referred to in the foregoing property settlement agreement which was to be and remain the individual property of Jared H. Miller, the first party to the agreement, and schedule "B" is a list of articles of personal property, referred to in that agreement, which was to be and remain the individual property of Cecil S. Miller, the second party to the agreement.]

Admitted in evidence Dec. 1, 1950.

Mr. Bouchard: And as the next exhibit a supplemental property settlement between the same parties dated April 19, 1938.

Mr. Flynn: No objection.

The Court: It may be admitted.

The Clerk: Exhibit 2.

(The document above referred to was marked Petitioner's Exhibit No. 2 and received in evidence.)

PETITIONER'S EXHIBIT No. 2

Supplemental Property Settlement Agreement

This agreement made April 19, 1938, by Jared H. Miller, of Negaunee, Michigan, hereinafter called the First Party, and Cecil S. Miller, of Fon-

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 2—(Continued)

tana, California, hereinafter called the Second Party;

Witnesseth:

Whereas, the parties hereto, on June 15, 1937, entered into a Property Settlement Agreement settling and adjusting their property rights of every kind, nature and description in any property belonging to them, or either of them, and establishing their mutual rights in such property; and

Whereas, by said agreement, First Party agreed, among other things, to convey to Second Party a life estate in the real property situated at Fontana, San Bernardino County, California, described therein as,

The East two and five hundred seventy-five thousandths (E. 2.575) acres of the North half of the East Half (N. $\frac{1}{2}$ of E. $\frac{1}{2}$) of Farm Lot Six Hundred Fifty-seven (657), as numbered and delineated on map showing subdivision of lands belonging to Semi-Tropic Land and Water Company, recorded in Book 11 of Maps at Page 12, records of San Bernardino County. The areas and distances of the above-described real property are computed to the centers of all adjoining streets and roads as shown on said map,

and did thereafter convey such life estate to Second Party; and

Whereas, by said agreement, First Party further

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 2—(Continued)

agreed, among other things, to pay all taxes on said property and to pay the balance of the principal of the purchase price of said property as it may fall due, together with interest thereon, then and now secured by a mortgage which is a first lien against said property; and to secure and keep in force adequate insurance against loss of the buildings on said property by fire; and upon demand of Second Party, but not prior to November 10, 1937, to expend the sum of \$750.00 for the improvement of said real estate at Fontana, California, and to expend such other sums for the improvement of said real estate from time to time as First Party might desire; and

Whereas, by letter of March 8, 1937, the First Party agreed to pay the sum of \$75.00 for a chair frame to be made to fit a certain Brussels silk Tapestry chair seat and chair back, inventory items numbers 378 and 379, included in Schedule B attached to and made a part of said property settlement agreement; and

Whereas, Second Party, by said property settlement agreement agreed, among other things, during her lifetime to pay all the expenses for the ordinary care and upkeep of said Fontana property and agreed not to incur any obligations for extraordinary expenses without the written approval of First Party; and

Whereas, the parties hereto now desire to terminate their several obligations hereinabove men-

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 2—(Continued)

tioned, as more particularly set forth and described in said property settlement agreement;

Now, Therefore, in consideration of the premises, and in consideration of the performance by each of said parties of their mutual agreements hereinafter contained, said parties do hereby stipulate and agree as follows:

First: First Party represents that the balance due on the purchase price of said Fontana property, secured by a mortgage on said property, is the sum of \$1,000.00, which said sum is due and payable on or before December 1, 1938, and that said mortgage is the only incumbrance against the said property. First Party agrees to pay said balance of the purchase price, with the interest thereon, when due, on condition that upon the signing of this agreement, Second Party will deliver to the attorney for the First Party to be delivered to a storage warehouse in Los Angeles, California, to be designated by First Party, the articles of personal property hereinafter mentioned, in good condition and unbroken, to be held by said storage warehouse for delivery to First Party upon the payment of said sum and the satisfaction of said mortgage, which said payment shall be evidenced by a statement of such payment and satisfaction signed by the mortgagee, to be delivered to said storage warehouse, and by it delivered to Second Party. The parties further agree that if business conditions are such at the time said payment of

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 2—(Continued)

said balance of the purchase price is due, that First Party finds it necessary to obtain and does obtain an extension or extensions of time within which to make the final payment thereon, this agreement shall continue in force until he shall have paid said balance in full and shall not be invalidated by reason of such extensions; provided, however, that said articles of personal property shall remain in storage and escrow until said balance has been paid in full.

Second: Second Party agrees that upon the signing of this agreement, she will cause to be delivered in good condition and unbroken, to the attorney for First Party, upon his receipt therefor, to be stored in such storage warehouse, the following articles of personal property, indicated upon Schedule B, attached to said property settlement agreement, by the numbers hereinafter set before each such article:

Inventory

Number	Description
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235—	One paid Bronze Torchones.
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242—	One Lemon Yellow Table Lamp, Blue Peacock Design.
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376—	Rene Lalique Black Vase.
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389—	Sheffield Soup Tureen.
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390—	Sheffield Candelabra (two pieces).
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391—	Sheffield Candle Sticks (two pieces).
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392—	Russian Cathedral Cope.
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(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 2—(Continued)

Third: First Party agrees that he will execute and, upon the delivery of said articles of personal property to said storage warehouse, as hereinabove provided, he will deliver to Second Party a grant deed of the real property at Fontana, California, hereinabove more particularly described, as the separate estate of Second Party. Second Party agrees that upon the delivery of said deed, First Party shall be relieved of his financial obligations with respect to the taxes upon and the care and maintenance of and the insurance against loss by fire of the buildings upon said real property, and he shall be further relieved of his obligations to expend the said sum of \$750.00, or any other sum, for the improvement of said real property, all as more particularly set forth and described in said Property Settlement Agreement, and he shall be further relieved of his obligation to pay the sum of \$75.00 for a chair seat and chair back, inventory items numbers 378 and 379, included in Schedule B attached to and made a part of said Property Settlement Agreement.

Fourth: Except as hereby modified, the provisions of said Property Settlement Agreement of June 15, 1937, shall remain in full force and effect.

Fifth: Said parties have been separately represented and fully advised by their own attorneys as to their respective rights and liabilities and as to the nature, extent and force of this agreement.

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 2—(Continued)

Sixth: This agreement shall bind the executors, administrators, representatives, heirs and assigns of the parties hereto and the testamentary trustees of the estate and will of First Party.

In Witness Whereof, the parties hereto have executed this agreement the day and year first above written.

/s/ JARED H. MILLER,
JARED H. MILLER,
First Party.

/s/ CECIL S. MILLER,
CECIL S. MILLER,
Second Party.

Admitted in evidence Dec. 1, 1950.

Mr. Bouchard: The respondent's counsel has asked me to offer and I will offer a certified photostatic copy of the summons in the case of Cecil S. Miller versus Jared H. Miller, and a copy, a photostatic copy of the complaint in that action. I think that the Clerk might clip the two together as one exhibit if he cares to.

Mr. Flynn: No objection.

The Court: Admitted.

The Clerk: Exhibit 3.

(The document above referred to was marked Petitioner's Exhibit No. 3 and received in evidence.)

(Testimony of Cecil Miller.)

PETITIONER'S EXHIBIT No. 3

In the Superior Court of the State of California
in and for the County of San Bernardino

No. 41354

CECIL S. MILLER,

Plaintiff,

vs.

JARED H. MILLER,

Defendant.

COMPLAINT FOR DIVORCE

Plaintiff complains of the above-named defendant, and for cause of action alleges:

I.

Plaintiff is a citizen of the United States and for more than one year last past has been a resident of Fontana, in the County of San Bernardino, State of California. Plaintiff and defendant now are husband and wife.

II.

The statistics required to be set forth by Section 426a of the Code of Civil Procedure are as follows:

Plaintiff and defendant were married in the City of Gardena, California.

The date of their marriage was December 24, 1921.

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 3—(Continued)

Plaintiff and defendant separated on or about July 24, 1936.

A period of approximately fourteen years and six months has elapsed between the date of said marriage and the date of separation.

There were no children born of said marriage.

III.

As cause for divorce, plaintiff alleges that during the period of approximately one year and six months last past defendant has been extremely cruel to the plaintiff and has inflicted grievous mental suffering upon her in the following particulars:

During the months of August and September, 1935, plaintiff was confined for medical and surgical care at a hospital in Rochester, Minnesota, returning to her home in Fontana with defendant from Rochester on or about October 1, 1935. While plaintiff was so confined in said hospital, defendant resided in Rochester at the home of one Mrs. Melvin Paulson, and defendant became infatuated with said Mrs. Melvin Paulson during said period of time, all without the knowledge of the plaintiff.

Immediately after Christmas in the year 1935, defendant, without informing plaintiff of the real purpose of his departure, left their home in Fontana, California, to return to Rochester, Minnesota, where he stayed substantially all of the time until his subsequent return to Fontana, California, on or about March 17, 1936, and plaintiff is informed and

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 3—(Continued)

believes, and upon such information and belief alleges that during said period of time, defendant stayed at the home of said Mrs. Melvin Paulson.

Upon the return of the defendant to their home in Fontana, California, plaintiff, through inadvertence, discovered several letters written to defendant by said Mrs. Melvin Paulson, expressing her love for the defendant and her infatuation for him. On the discovery of said letters, plaintiff confronted defendant with the knowledge so obtained of his relations with said Mrs. Paulson, and defendant thereupon admitted the fact that he was in love with the said Mrs. Paulson and stated that he did not feel that he could continue to live with the plaintiff. Thereafter, during the month of May, 1936, defendant, in a letter to the said Mrs. Paulson, stated to her that the situation between them had been accidentally discovered and "thus there has occurred all the elements of a very sad case of the eternal triangle," and in said letter expressed his love for her and his desire to please her in preference to pleasing plaintiff. Plaintiff does not know whether said letter was in fact sent to Mrs. Paulson.

Another letter of the same character was thereafter written by the defendant to the said Mrs. Paulson again expressing his love for her and his desire to get said plaintiff used to the idea of their relations and his further desire to have the reply which the said Mrs. Paulson might write to said letter, in such shape that defendant could show it

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 3—(Continued)

to the said plaintiff, and in said letter to said Mrs. Paulson made some suggestions as to the sort of letter she should write to defendant, purporting to express her willingness to wait until such time as defendant might join her. Plaintiff inadvertently discovered said letter, written in longhand by defendant, but does not know whether it was ever sent.

Thereafter, on or about July 24, 1936, defendant departed from his home in Fontana, California, and on about September 22, 1936, by letter addressed to plaintiff, advised her that he had come to a decision regarding the affairs of the plaintiff and the defendant, stating in part that he had given careful consideration to their relations and to the possibility of his returning to live with her as husband and wife, and that he had come to the conclusion that he did not want to do it, saying that he did not have any real desire to return to her and that his every feeling was against it, and expressing his desire to enter into an agreement for her support and maintenance and for her care during the natural life of the plaintiff. Thereupon, plaintiff, at the instance of the defendant, entered into negotiations with him for the settlement of their affairs.

At the time plaintiff discovered defendant's relations with the said Mrs. Melvin Paulson, she was not in good health and was then and ever since has been under the care of physicians. The discovery

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 3—(Continued)

of said relationship and the subsequent events with reference to the negotiations for the completion of said settlement agreement have aggravated her ill health and caused her grievous mental suffering and distress.

IV.

The plaintiff and defendant have entered into a property settlement agreement and an agreement for the care and maintenance of the plaintiff during the rest of her natural life, dated June 15, 1937. Said agreement is acceptable to the plaintiff and will be submitted to the above-entitled court on the hearing of this action, for approval of the court.

Wherefore, plaintiff prays that the bonds of matrimony now existing between herself and the defendant be dissolved and that the property settlement agreement between the parties to this action, dated June 15, 1937, be ratified and approved, and that the plaintiff may have her costs and such further and equitable relief as may seem just and proper.

/s/ PHILBRICK McCOY,
Attorney for Plaintiff.

In This Action, the defendant, Jared H. Miller, having been regularly served with process, and having failed to appear and answer the plaintiff's complaint on file herein, and the time allowed by law for answering having expired, the default of

(Testimony of Cecil Miller.)

Petitioner's Exhibit No. 3—(Continued)
said defendant in the premises is hereby duly entered according to law.

Attest: My hand and the seal of said Court, this
30th day of July, 1937.

[Seal] /s/ HARRY L. ALLISON,
Clerk.

By /s/ [Indistinguishable],
Deputy Clerk.

[Duly verified.]

[Certified true copy.]

[Admitted in evidence, Dec. 1, 1950.]

Mr. Bouchard: And next a certified copy of the interlocutory decree of divorce.

Mr. Flynn: No objection. [22]

The Court: Admitted.

The Clerk: Exhibit 4.

(The document above referred to was marked
Petitioner's Exhibit No. 4 and received in evidence.)

(Testimony of Cecil Miller.)

PETITIONER'S EXHIBIT No. 4

[Title of Superior Court of California, San Bernardino County, and Cause.]

No. D-41354

INTERLOCUTORY JUDGMENT
OF DIVORCE

(Default)

This cause came on to be heard the 23rd day of August, 1937, in Department 3, Philbrick McCoy, Esquire, appearing as attorney for plaintiff, and it appearing that defendant was duly served with process and has not appeared or answered the complaint, and that the default of defendant has been entered:

It Is Adjudged that plaintiff is entitled to a divorce from defendant; that when one year shall have expired after the entry of this interlocutory judgment a final judgment dissolving the marriage between plaintiff and defendant be entered, and at that time the Court shall grant such other and further relief as may be necessary to complete disposition of this action.

It is further ordered, adjudged and decreed that the Property Settlement Agreement, dated June 15, 1937, between Jared H. Miller, the above-named defendant, and Cecil S. Miller, the above-named plaintiff, and filed with this court as an exhibit in

(Testimony of Cecil Miller.)

the above-entitled proceeding, be and the same hereby is approved.

Done in open Court this 23rd day of August, 1937.

CHAS. L. ALLISON,
Judge.

[Endorsed]: Filed and entered August 24, 1937,
Superior Court.

Admitted in evidence December 1, 1950, U.S.D.C.

Mr. Bouchard: And the last exhibit is a certified copy of the final judgment of divorce in this case.

Mr. Flynn: No objection.

The Court: It is admitted.

The Clerk: Exhibit 5.

(The document above referred to was marked
Petitioner's Exhibit No. 5 and received in evidence.)

PETITIONER'S EXHIBIT No. 5

[Title of Superior Court of California, for San Bernardino County, and Cause.]

No. D-41354

FINAL JUDGMENT OF DIVORCE

In this cause an interlocutory judgment was entered on the 24th day of August, 1937, adjudging

(Testimony of Cecil Miller.)

that plaintiff was entitled to a divorce from defendant, and more than one year having elapsed, and no appeal having been taken from said judgment, and no motion for a new trial having been granted and the action not having been dismissed;

Now, upon the Court's own motion, it is adjudged that plaintiff be and is granted a final judgment of divorce from defendant and that the bonds of matrimony between plaintiff and defendant be, and the same are, dissolved.

It is further ordered and decreed that wherein said interlocutory decree makes any provision for alimony or the custody and support of children, said provision be and the same is hereby made binding on the parties affected thereby the same as if herein set forth in full, and that wherein said interlocutory decree relates to the property of the parties hereto, said property be and the same is hereby assigned in accordance with the terms thereof to the parties therein declared to be entitled thereto.

Done in open Court this 25th day of August, 1938.

[Seal] /s/ CHAS. L. ALLISON,
Judge.

[Endorsed]: Filed and entered August 25, 1938,
Superior Court.

Admitted in evidence December 1, 1950, U.S.D.C.

(Testimony of Cecil Miller.)

Q. (By Mr. Bouchard): Mrs. Miller, where do you reside? A. In Fontana, California.

Q. Is that in San Bernardino County?

A. Yes, sir.

Q. And you and Jared H. Miller, better known as Dr. Miller, were married in 1921, is that right?

A. Yes, sir.

Q. And had Dr. Miller been married before?

A. Yes, sir; four times.

Q. You were his fifth wife? A. Yes, sir.

Q. Was Dr. Miller older than you?

A. About 20 years. [23]

Q. Had you been married previously?

A. Once.

Q. And is your husband living or dead?

A. He died of tuberculosis. He died in 1913, of tuberculosis.

Q. You did not remarry until you married Dr. Miller in 1921? A. No.

Q. Did you have any children by your first marriage? A. Yes.

Q. A boy? A. A boy.

Q. And how old was he when your first husband died? A. About two years old.

Q. Now, Mrs. Miller, you and Dr. Miller continued to live in Los Angeles for how long after 1921?

A. We moved out to Fontana in April, I think, of 1923.

Q. And then you continued to live in Fontana

(Testimony of Cecil Miller.)

from 1923, until your separation in 1936, is that right? A. Yes.

Q. Now, I want you to skip over a period of time and go to a trip which you and Dr. Miller took sometime in December of 1934. Would you tell the court where you and Dr. Miller went?

A. We left here the day after Christmas in 1934, and [24] drove to Florida. We stayed there a couple of weeks and then went to Washington, D. C. There we left the car and went to New York and took a boat on a Mediterranean cruise and spent the month of April in London. We came back to New York and picked up the car and toured all through the New England States, Nova Scotia and Canada, and then went to Michigan where we spent a month.

Q. Then where did you go?

A. Then on the way home we stopped at Mayos. I had had stomach trouble all my life and we had always thought that some day we would go to Mayos and have an examination, and we stopped there, and after the examination I spent three weeks in the hospital.

Mr. Flynn: If the court please, it appears that the grounds for the complaint and the ground for the divorce are set forth in the complaint and I think unless counsel can show some purpose of going back that far to 1934, and to trips and that sort of thing, unless he has some other purpose in mind, I submit it is clearly irrelevant.

(Testimony of Cecil Miller.)

The Court: I assume that he has or he wouldn't be going back that far.

Mr. Bouchard: It will be disclosed, I hope.

The Court: All right.

Q. (By Mr. Bouchard): You underwent surgery? [25] A. Yes, sir.

Q. And then you and Dr. Miller returned to your home in Fontana about October 1, 1935?

A. Yes, sir.

Q. And continued to reside there until he left in July of 1936? A. Until January.

Q. He made a trip in January of 1936? Where did he go?

A. He went to Rochester, Minnesota.

Q. What reason did he give for going?

A. His daughter-in-law was expecting a baby and he wanted to be there when the child was born.

Q. When did he return from that trip?

A. Around the middle of March.

Q. 1936? A. Yes.

Q. Did anything happen at that time to mar the even tenor of your whole life? A. Yes, sir.

Q. Did you ever discover any letters?

A. Yes, I did.

Q. And what letters did you discover?

A. I discovered some letters from a woman in Rochester, Minnesota. [26]

Q. And what did those letters indicate to you?

A. They indicated that he had been on very intimate terms and relations.

Mr. Flynn: The complaint covers all of this,

(Testimony of Cecil Miller.)

your Honor, and if there is going to be testimony about the letters, I think the letters ought to be produced. I don't know why we are going through all of this. I don't see what we are accomplishing, Judge.

The Court: I don't know yet, but we haven't spent too much time on it.

Mr. Bouchard: I submit that he hasn't made an objection.

Q. (By Mr. Bouchard): Mrs. Miller, did you confront the doctor with those letters?

A. I did.

Q. What was the upshot of your discussion with him?

A. Well, he asked me what I wanted him to do, and I said, "I didn't see why we couldn't go on as we had," and we said we would try it.

Q. Did he make any statement to you to the effect that you forget the matter and he would forget this woman?

A. That he would try.

Q. And that was the understanding?

A. Yes. [27]

Q. Now, he made a trip east in July of 1936, did he not?

A. Yes.

Q. What was the occasion for that trip?

A. His annual trip to Michigan to oversee the mining properties and check up on things.

Q. And before he left did he make any improvements or changes in the house?

A. Yes, he took the garage and turned it into a library for himself to put some of his curios and

(Testimony of Cecil Miller.)

collections in, and made the garage over in the poultry plant, and that was not completed when he left. The inside was not finished.

Q. Now, when he left did he give you or did he tell you when he expected to return?

A. Yes, he gave me the date of his return.

Q. And when did he tell you he would return?

A. In September.

Q. Of '36? A. Yes.

Q. And during the absence in July and August did you hear from him? A. Yes.

Q. And did you write to him? A. Yes.

Q. Did he ever come back? [28] A. No.

Q. When did you first learn that he didn't intend to return?

A. He wrote me a letter in September, the latter part of September, that he was not returning.

Q. September of 1936?

A. That he thought things over and he didn't think it would hurt and he was not coming back.

Q. Did he say anything to you about any provision he was willing to make for you?

A. Yes. He had been giving me a check for \$400 a month and he said he would continue to do that.

Q. He would continue to give you \$400 a month, and did he suggest to you that you should see some attorney and negotiate a property settlement agreement? A. Yes.

Q. And you then in October of that year, 1936, consulted Mr. Philbrick McCoy? A. Yes.

(Testimony of Cecil Miller.)

Q. And that was Judge McCoy who was on the stand preceding you? A. Yes.

Q. He was then a practicing lawyer in this city?

A. Yes.

Q. And in that letter of September of 1936, that you [29] received did Dr. Miller say anything to you about a divorce? A. No.

Q. After you received that letter did you ever hear from him again? A. No.

Q. And did you ever have any discussion with your husband about the subject of divorce?

A. No.

Q. Never did? A. No.

Q. Now, who conducted the negotiations in your behalf? A. Mr. McCoy.

Q. In arranging this property settlement agreement? A. Yes.

Q. Do you know who made the first proposal of a settlement? A. I don't remember.

Q. Do you know whether he made it or did Mr. McCoy tell you that they had made it? Do you recall? A. I don't recall.

Q. Did you instruct Mr. McCoy to make any demand for the property agreement?

A. I think he got in touch with Mr. Potter, Dr. Miller's attorney, and he took it up with Dr. Miller, and he said as a provision that he would give me \$400 a month and [30] a place to live in Fontana as long as I lived.

Q. And did you accept that? A. No.

(Testimony of Cecil Miller.)

Q. What was your offer or demand?

A. Well, I thought I should have an interest, or a part of the interest in the estate in Michigan, which I understood, by Michigan law, I was entitled to.

Q. Did Mr. McCoy advise you as to whether or not that sort of deal was acceptable to Dr. Miller?

A. It wasn't.

Q. It was not? A. No.

Q. And did Mr. McCoy advise you that Dr. Miller had offered in lieu of your demand to increase his offer to \$6,300 a year and the Fontana property and a provision for your mother and son?

A. Yes.

Q. Was that offer acceptable to you?

A. Yes.

Q. And do you recall about when it was that Mr. McCoy advised you that the financial arrangements could be made?

A. It was either January or February.

Q. Now, this property settlement, Mrs. Miller, was not signed until apparently June of 1937, June 15th of 1937. Do you know why it took so many months before—took so many [31] months from January until May to get this property settlement agreement in shape?

A. Well, because of the correspondence that had gone on between Michigan and out here in regard to this division of the personal property.

Q. And the division that was ultimately made was the division that is shown in the property

(Testimony of Cecil Miller.)

schedule marked Schedules A and B, is that right?

A. Yes.

Mr. Bouchard: May I interject to your Honor, that when you examine it you will find that it is very extensive and covers a good many pages.

Q. (By Mr. Bouchard): Now, Mrs. Miller, at any time after Dr. Miller left in July of 1936, was there ever any discussion between you and him about divorce? A. No, I never saw him.

Q. You never saw him and you never heard from him?

A. Not directly. All I had was copies of the letters he sent to Mr. McCoy.

Q. At any time while this property settlement agreement was being negotiated did Mr. McCoy tell you that Dr. Miller wanted you to get a divorce?

A. I don't recall that he did.

Q. Did you ever discuss with Mr. McCoy the subject of [32] a divorce? A. I may have.

Q. Well, did you? A. I probably did.

Q. Well, you ultimately started suit for divorce in San Bernardino County, did you not?

A. Yes.

Q. This exhibit shows that it was started on the 22nd or 23rd of June, 1937, shortly after the signing of the property settlement agreement.

How long before that time did you talk to Mr. McCoy about getting the divorce?

A. Well, I wouldn't set any date. It wasn't long before I started it.

(Testimony of Cecil Miller.)

Q. Was it after the property settlement—you had been advised that the property settlement agreement had been agreed upon before you talked about it? A. Yes.

Q. Did you give Mr. McCoy any reason as to why you thought you would secure a divorce?

A. Well, we had a lot of friends in Fontana and I was constantly embarrassed when I was out by being asked when Dr. Miller was returning and I was always evading it because I was ashamed to say that I had been abandoned and left. So I decided I might as well get a divorce and have it on [33] the record.

Q. And so far as you were concerned then I get it from your testimony that you and Dr. Miller never discussed the subject of a divorce? In fact, you never heard from him and that you were never advised by Mr. McCoy that Dr. Miller's attorneys had discussed the matter of divorce with him?

A. No.

Mr. Bouchard: You may cross-examine.

Cross-Examination

By Mr. Flynn:

Q. Mrs. Miller, you stated that you received a letter from Dr. Miller advising you to see an attorney about a divorce, didn't you?

A. Not about a divorce.

Q. About a settlement?

A. About a settlement.

(Testimony of Cecil Miller.)

Q. Do you know which attorney that was? Did he mention the name of an attorney in that letter?

A. I don't remember that he did.

Q. Did you ever see any attorney before you went to Attorney McCoy at that time?

A. I was referred to Mr. McCoy by Mr. Potter.

Q. Did you go to see Mr. Potter? A. Yes.

Q. What did you go to see Mr. Potter [34] about?

A. I showed him the letter that I had received from Dr. Miller about his not returning and I asked him if he could act as my attorney in making up this agreement, and he said he would ask the doctor for his permission.

Q. You talked generally about a divorce to Mr. Potter, didn't you? A. No, I didn't.

Q. Didn't you mention divorce at all?

A. No.

Q. Then Mr. Potter referred you to Mr. McCoy?

A. He received a letter from Dr. Miller saying he would not release him, so he referred me to Mr. McCoy.

Q. Now, did you ever receive any letter from Dr. Miller, Mrs. Miller, at any time before June 15, 1937, referring to the word "divorce"?

A. I don't recall that I did. All the correspondence went through the attorneys after I went to Mr. McCoy.

Q. Can you indicate definitely that you never received any letter at all from him prior to that date regarding divorce?

(Testimony of Cecil Miller.)

A. I don't remember that I did.

Q. Your answer is you do not remember?

A. I do not remember.

Q. Now, you looked over this complaint for divorce, didn't you, Mrs. Miller? [35]

A. Yes.

Q. Before you signed it?

A. Yes. I haven't looked at it since.

Q. You signed this divorce, Mrs. Miller, right about the same time you were entering into the property agreement, didn't you?

A. No, it was after the property agreement had been agreed on.

Q. Do you remember how long after it was?

A. No.

Q. Within a few days, I suppose, wasn't it?

A. The main part of the property agreement had been agreed upon several months before.

Q. You signed a different agreement several months before June 15th?

A. No, we didn't sign it, but it was agreed upon.

Q. The only agreement that was signed up until that time was that one, wasn't it? A. Yes.

Q. When did you first talk to Mr. McCoy about a divorce, Mrs. Miller?

A. I don't remember what date. It has been a long time and I can't remember the date.

Q. It was around the same time that you were discussing the property agreement, wasn't it? [36]

(Testimony of Cecil Miller.)

A. No, it was not until after we had gotten that all settled that I said anything about a divorce.

Q. It was before you signed the property agreement, wasn't it?

A. I probably said I would get a divorce.

Q. Who did you say that to?

A. Mr. McCoy.

Q. Do you remember how long it was before that—

Mr. Bouchard: I wish both of you would speak up a little louder. I am having trouble hearing both of you.

Q. (By Mr. Flynn): Do you remember how long it was, Mrs. Miller, before you signed the divorce that you told Judge McCoy that you would get a divorce?

A. No, I don't because I didn't want a divorce. I didn't need a divorce. I never have needed a divorce.

Q. But now you said a minute ago that you did say to Judge McCoy or might have said that you would get a divorce?

A. I think that was brought out in Mr. McCoy's testimony.

Q. My question is, Mrs. Miller, do you remember how long it was?

A. I don't remember how long, no.

Q. The question is, how long before. Do you know how long it was before just so the record is clear? Do you know [37] how long it was before you

(Testimony of Cecil Miller.)

signed the agreement that you told Mr. McCoy that you would get a divorce? That was the question.

Now, your answer to that is what?

A. I don't know.

Q. Mrs. Miller, I show you your 1945 income tax return and I ask you if that is your signature?

Mr. Bouchard: I will admit that is a copy if you want to offer it into evidence.

Mr. Flynn: For 1945 and 1946, respectively. I offer them as exhibits.

The Clerk: The 1945 income tax return is Exhibit A, and the 1946 income tax return is Exhibit B.

The Court: They may be received.

(The documents above referred to were marked Respondent's Exhibits A and B and received in evidence.)

RESPONDENT'S EXHIBIT "A"

[This Exhibit is the United States individual income tax return for the calendar year 1945 of Cecil A. (Anabel) Miller and shows that the only item of gross income which she received during that year was \$6,300, as is evidenced by the following Schedule attached thereto:]

The taxpayer's only income is the sum of \$6,300.00 received from her former husband, Jared H. Miller, 390 Grove Street, Pasadena, California, pursuant to a property settlement agreement entered

(Testimony of Cecil Miller.)

into between them October 15, 1937. The taxpayer contends that this income is not taxable income to her under the provisions of section 22(k) of the Internal Revenue Code, for the reason that the payments received under said agreement are not in discharge of the legal obligations of the husband under the decree of divorce and are not an incident to the divorce. See *Frank v. Commissioner*, 51 F.(2d) 923 (C.C.A.3). A copy of the property settlement agreement herein referred to was attached to the return of the taxpayer filed with the Collector of Internal Revenue in 1943 of her income for 1942.

Dated at Fontana, California, February 26, 1946.

/s/ CECIL ANABEL MILLER.

Admitted in evidence Dec. 1, 1950.

RESPONDENT'S EXHIBIT "B"

[This Exhibit is the United States individual income tax return for the calendar year 1946 of Cecil Anabel Miller, and shows that the only item of gross income which she received during the year was \$6,300, as is evidenced by the following Schedule attached thereto as follows:]

(Testimony of Cecil Miller.)

February, 1947

March 4, 1947

Collector of Internal Revenue,
Federal Building,
Los Angeles 12, California.

Dear Sir:

The attached return is filed as required by law. It is considered by the taxpayer that Dr. Jared H. Miller, 390 Grove Street, Pasadena, California, is liable for the taxes due on the income of \$6,300.00 as indicated on the attached return, and that the undersigned is not liable therefor, by reason of the provisions of Section 22(k) of the Internal Revenue Code.

The liability of Jared H. Miller, and the non-liability of Cecil S. Miller, is fully explained in the rider attached to the return of Cecil S. Miller, under the name of "Cecil A. Miller" on form #1040, for the calendar year of 1942, filed in March, 1943, in this office and is based on the terms of a Property Settlement Agreement between the parties dated August 15, 1937, a copy of which agreement was filed with your office with said rider.

Reference is also made to your letter of September 26, 1946, to the taxpayer's attorney, Philbrick McCoy, Esq., and his letters to you in reply of September 30, and October 2, 1946.

CECIL S. MILLER.

Admitted in evidence Dec. 1, 1950.

(Testimony of Cecil Miller.)

Q. (By Mr. Flynn): Now, Mrs. Miller, I show you your 1945 income tax return and I call your attention to the figure of \$6300, which appears on lines 4 and 5 and ask you if that is the \$6300——

Mr. Bouchard: I will stipulate that it is on both returns.

Mr. Flynn: That it is?

Mr. Bouchard: That \$6300 is the amount she received from Dr. Miller under this property settlement agreement. [38]

Q. (By Mr. Flynn): You had no other income then during those years besides that? A. No.

Q. No income from any property of any kind?

A. No.

Q. Did you own any property of your own before you married Dr. Miller? A. No.

Q. You were a resident of California at the time?

A. I was born in California. I have always lived in California.

Q. And your legal residence was in California when the divorce was granted and when the property agreement was entered into? A. Yes.

Q. You say you live in Fontana right now?

A. Yes.

Q. Is that one of the properties that was originally owned by Dr. Miller? A. No.

Q. How long have you lived at your present address? A. Five years.

Q. Before that time where did you live?

(Testimony of Cecil Miller.)

A. I lived at 348 North Juniper Street.

Q. In Fontana? [39] A. Yes.

Q. That is where you lived when you lived with Dr. Miller?

A. No, we bought another house and sold that and moved into the grove, but that is where I lived when he left.

Q. After the divorce, Mrs. Miller, you continued to reside in the same house in which you were living with Dr. Miller, did you not? A. Yes.

Q. You stated that you made an offer or Dr. Miller made an offer to pay you \$400 a month, didn't you? A. He made the offer.

Q. Did he ever make you—when did he make you the offer of \$400 a month?

A. When he left on his trip in January.

Q. Of what year? A. 1936.

Q. January of 1936?

A. He deposited \$400 a month to my account to run the house on.

Q. How long did those deposits of \$400 a month continue?

A. Until the property settlement agreement went into effect.

Q. In connection with the property settlement agreement, [40] Mrs. Miller, you were advised by Judge McCoy as to approximately when the divorce would be entered, were you not? He gave you a pretty good idea as to when the divorce would be entered, didn't he? A. I suppose he did.

(Testimony of Cecil Miller.)

Q. And then how long it would take after that to get the divorce? A. Yes.

Q. This \$6300 which you received from the agreement, how did you receive that, directly in cash or by check?

A. No. There was a check for \$1200 sent to the bank and deposited in my account every three months and on December 15th the check for \$1500 was deposited extra.

Mr. Flynn: I have no further questions.

Mr. Bouchard: Mrs. Miller, I have one question.

Redirect Examination

By Mr. Bouchard:

Q. We have been talking about some mining properties that Dr. Miller had in Michigan. Do you know how he acquired those properties?

A. By inheritance.

Q. From whom?

A. From his former wife.

Q. The one who preceded you?

A. Yes. [41]

Q. In answer to one of Mr. Flynn's questions he asked you if you had ever received any letter from Dr. Miller about a divorce, and your answer to him was that you did not remember receiving any.

Didn't you tell me and haven't you told me in my office that you never received any letters from Dr. Miller after the letter of September 22, 1936,

(Testimony of Cecil Miller.)

in which he wrote you and said he was not going to return? Didn't you tell me that you had not received any after that time?

A. Well, I answered that letter before I went to see any attorney and I probably received an answer from him sometime saying that he was not returning.

Q. Well, at least during that period——

A. I didn't have any correspondence with him. It was all carried on through Mr. McCoy and Mr. Potter.

Q. Outside of the letter you received in September of 1936 and you replying to that letter, you never heard from him again?

A. I never had a letter from him about anything.

Mr. Flynn: I object to that as a leading question.

The Court: I think she said that before. At least, I understood her to say so.

Mr. Bouchard: No further questions.

The Court: Mr. Flynn.

Mr. Flynn: No questions. [42]

The Court: The witness is excused.

(Witness excused.)

The Court: Anything further?

Mr. Bouchard: The Petitioner rests.

Mr. Flynn: Yes, your Honor, I have two witnesses. I would like to call first of all Mr. Potter.

Whereupon,

BERNARD POTTER

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

The Clerk: Have a seat, sir, and state your name and address.

The Witness: Bernard Potter, and my business address is 433 South Spring Street.

Direct Examination

By Mr. Flynn:

Q. Mr. Potter, what is your occupation?

A. I am an attorney at law.

Q. Here in Los Angeles?

A. In Los Angeles.

Q. How long have you been an attorney in Los Angeles? A. Since 1894.

Q. Do you know Mrs. Miller, who just left the stand? A. I do. [43]

Q. Did you ever talk to Mrs. Miller about a divorce in the year 1936 or 1937?

A. I don't know that I can answer that question directly except in this way: I had known Mrs. Miller and Dr. Miller for a great many years, Dr. Miller particularly, as I had been acting as his attorney up to that time.

Mrs. Miller came into my office in October, I am quite sure it was in 1936, and she then started in to say that Dr. Miller had another woman and that she had certain letters from this woman that

(Testimony of Bernard Potter.)

disclosed his infidelity and so forth and wanted to know if I would take action against him.

I immediately told her that I couldn't go into the merit of her case because I was his attorney and I didn't feel that I could. Whether I said to her that I would endeavor to secure his consent to or a waiver, I don't believe I did, but there is a possibility that I might have. At least, I said I couldn't discuss the merit of the case with her. She was very wrought up and so forth at that time and I don't know whether, but I do think she suggested to me that I secure—or she asked me to suggest some other lawyer and I suggested Philbrick McCoy, who was then a practicing attorney.

Whether the question of divorce directly was mentioned at that time I wouldn't want to say positively, but it was a proceeding that she wanted to take against him, which I [44] understood was a divorce proceeding, because she said it was impossible for her to live with him and that they had separated.

Q. Then you represented Dr. Miller in connection with the proceeding, did you not?

A. I represented him in connection with all of the proceedings that led up both to the divorce and to the property settlement?

Q. Did you draw the property settlement agreement?

A. I don't remember whether I had it drawn in

(Testimony of Bernard Potter.)

my office or not, but we collaborated on it. Mr. McCoy and I talked it over many times—the substance of it, and we endeavored to agree upon it and what was agreed upon later.

Q. What was your understanding, Mr. Potter, as to the connection between the divorce and the property settlement agreement?

Mr. Bouchard: I object to that as being an incompetent question. What his understanding is is not important.

Mr. Flynn: I will withdraw the question, your Honor.

Q. (By Mr. Flynn): Did you have any discussion with Mr. McCoy regarding whether or not the divorce would be contingent upon entering into the agreement?

A. I had many talks with Mr. McCoy about the whole matter and also about the question of the divorce. It was stated to me—stated to him by me that Dr. Miller would not [45] consider entering into any property settlement whatsoever unless a divorce was procured, and that of course, it could not be procured by him, but by her. In fact, I have forgotten the date now, but the letter here will disclose that—that prior to the 15th day of June when this property settlement was executed and the decree of divorce or the divorce was filed on the 22nd or 23rd of the same month, along prior to that, and arrangement was made by which Mr. McCoy was to be paid for securing this divorce. I

(Testimony of Bernard Potter.)

think \$250.00 was paid down to him by Dr. Miller through me.

I don't know what that letter states. He calls attention to the fact—Mr. McCoy does—that there is due him \$250.00 for the divorce.

The whole property settlement was predicated upon the understanding that a divorce would be filed, a divorce suit would be filed.

Q. That was your understanding at that time?

A. It is not my understanding, my knowledge.

Q. And in that connection did you indicate to Mr. McCoy whether or not the divorce would be a contested matter?

A. Well, you must remember in those days—if I digress a little bit, your Honor——

Mr. Bouchard: I shall object to any digressions being made. Answer the question.

The Witness: Repeat the question. [46]

The Court: Mr. Reporter, would you read the question, please?

(The question was read.)

The Witness: It was never agreed that it would be an uncontested matter, but, of course, we understood that the doctor would not fight the case. However, there was no agreement to that effect. That would have been against public policy.

Q. (By Mr. Flynn): Mr. Potter, I show you a letter dated July 13, 1937, addressed to Mr. Bernard Potter, Senior, Esquire.

A. Yes.

(Testimony of Bernard Potter.)

Mr. Bouchard: May I see it, please?

Q. (By Mr. Flynn): It is signed by attorney Philbrick McCoy, and I ask you if that is one of the letters you received from Mr. McCoy?

A. That is a letter which I received from Attorney McCoy. This portion of it says——

Mr. Bouchard: Just a moment. He didn't ask you to read it.

Q. (By Mr. Flynn): Would you read the letter?

Mr. Bouchard: It isn't in evidence.

Mr. Flynn: I beg your pardon. [47]

Q. (By Mr. Flynn): Is this letter exactly as you received it from Mr. McCoy?

A. It is except there is some red pencil marks around here.

Q. Excluding the red pencil marks and the other pencil marks, is that letter just exactly as you received it? A. That is true.

Mr. Flynn: The Respondent offers this letter into evidence.

Mr. Bouchard: I object to the receipt of that letter into evidence because it is dated July 13, 1937, which is after the execution of the agreement and after the commencement of the action.

The Court: May I see it?

Mr. Bouchard: I object on the further grounds it doesn't tend to prove any issue in this case.

The Court: It may be admitted for what it may be worth.

(Testimony of Bernard Potter.)

The Clerk: Exhibit C.

(The document above referred to was marked Respondent's Exhibit C for identification and received in evidence.)

RESPONDENT'S EXHIBIT C

Philbrick McCoy

Attorney at Law

1015 Spring Arcade Building

Los Angeles, California

July 13, 1937.

Bernard Potter, Sr., Esquire,
Chester Williams Building,
Los Angeles, California.

My dear Mr. Potter:

I had a letter this morning from Mrs. Miller, who is on a trip up north, asking me, among other things, to notify Dr. Miller that she would like to have all checks from him pursuant to the recent property settlement agreement, made payable to Bank of America, Fontana Branch, Fontana, California, and sent to that bank with instructions to deposit the checks in Mrs. Miller's account. Would you be good enough to convey this information to Dr. Miller? I think the request will eliminate any difficulty which might otherwise arise as to the payment of the monies.

I understood you to say last month just prior to Dr. Miller's departure, that upon his return east

(Testimony of Bernard Potter.)

he would send me his check for \$250.00 to cover my fees for services to Mrs. Miller in connection with the pending divorce action. Will you remind him of this when you write him? You might tell him that I shall enter his default as soon as the thirty days have expired after service of the summons and complaint, but it would not seem likely that the matter can be set for hearing much before the end of August. I will keep you posted, however, as to the progress of the case and let you know if anything occurs in the meantime.

Permit me to take this occasion to say that it has been a pleasure to deal with you during the past several months on behalf of Mrs. Miller. It is not always that we have such pleasant experiences.

With kindest personal regards, as always, I am

Sincerely yours,

/s/ PHILBRICK McCOY.

PMcC:dc

Admitted in evidence Dec. 1, 1950.

Q. (By Mr. Flynn): Mr. Potter, I show you a letter from Mr. Philbrick [48] McCoy addressed to Bernard Potter, Senior, dated February 12, 1943. Is that letter, Mr. Potter, precisely the way it was when you received it shortly after February 12, 1943, with the exception of the pencil and ink marks on the letter? A. It is.

(Testimony of Bernard Potter.)

Mr. Flynn: The Respondent offers this letter as our next exhibit.

Mr. Bouchard: It is incompetent, irrelevant, and immaterial. It is a letter written in 1943 and has no bearing upon any of the issues in this case.

The Court: May I see it?

I don't see any relevancy in this letter, Mr. Flynn.

Mr. Flynn: I assumed it was relevant on the ground Judge McCoy when he was on the stand testified regarding the conversations in the latter years—prior to the taxable years—regarding Mrs. Miller's tax liability.

The Court: I don't see how it is material. The question is not when—the question is not what they did in 1943, but at the time of this agreement and the time of the divorce. I don't see any relevancy and the objection is sustained.

Q. (By Mr. Flynn): Mr. Potter, I show you a letter addressed to Dr. Jared H. Miller signed by you, dated May 3, 1937.

Mr. Bouchard: Counsel, may I suggest to save time [49] that if you have several letters that you would like to show the witness you let me have them while you are examining him on other matters and it will save time.

Q. (By Mr. Flynn): Mr. Potter, I show you a letter, the letter I called your attention to a minute ago, dated May 3, 1937, and ask you if that is your signature?

A. That is.

Q. And is that the letter which you wrote to Dr. Miller about—

A. It is.

(Testimony of Bernard Potter.)

Mr. Flynn: I offer the letter into evidence as the Respondent's exhibit next in order.

Mr. Bouchard: I object to that for the reason that the letter is from Mr. Potter to his client and is in no way binding upon the Petitioner in this case.

The Court: There might be some collaboration of the witness' testimony in there and it may be received.

Mr. Bouchard: I have read the letter.

The Clerk: Exhibit D.

(The document above referred to was marked Respondent's Exhibit D for identification and received in evidence.)

RESPONDENT'S EXHIBIT D

Potter & Potter

Attorneys at Law

Suite 814 Chester Williams Building

Los Angeles, California

May 3, 1937.

Dr. Jared H. Miller,
P. O. Lock Box 685,
Rochester, Minn.

Dear Doctor:

Your letter of May 1st just received, in which you stated that if I thought it advisable I could phone Mr. McCoy what you stated in regard to your probable adoption of the agreement in its

(Testimony of Bernard Potter.)

present form with minor changes. Also that you would wait for your final decision until you had seen Mr. Wheat.

While I was talking with him over the phone he asked if it was likely that you would be in Los Angeles around the time the settlement was finally agreed upon as it would expedite matters with regard to the divorce; that is, if you were here you could be served with the papers and the matter disposed of quickly. I told him that I did not know positively whether you would be here or not, but I thought some mention had been made in one of your letters that there was such a possibility.

I have not had a chance to get hold of Mr. Doody yet with regard to the oil matters, but I will do so at once.

The reason I am writing you upon the receipt of your letter is that you say "Please send the enclosure forward to Mrs. Miller at once." No doubt you referred to her check, but the check was not enclosed. You perhaps have discovered this and sent it on to me, but if not you will know that the check was not enclosed.

As soon as I have interviewed Mr. Doody I will then write you again fully.

Sincerely yours,

/s/ BERNARD POTTER.

BPSr:PW

Admitted in evidence Dec. 1, 1950.

(Testimony of Bernard Potter.)

Q. (By Mr. Flynn): Mr. Potter, I show you a letter dated May 17, 1937, [50] addressed to Dr. Jared H. Miller, purportively signed by you, and ask you if that is your signature at the bottom of that letter? A. It is.

Q. And is that letter with the exception of the pencil marks and the ink marks on it exactly as you sent it to Dr. Miller? A. That is true.

Mr. Flynn: I offer the letter into evidence as Respondent's exhibit next in order.

Mr. Bouchard: I don't object.

The Court: It is admitted.

The Clerk: Exhibit E.

(The document above referred to was marked Respondent's Exhibit E for identification and received in evidence.)

RESPONDENT'S EXHIBIT E

Potter & Potter

Attorneys at Law

Suite 814 Chester Williams Building

Los Angeles, California

May 17, 1937.

Dr. Jared H. Miller,
P. O. Box 685,
Rochester, Minnesota.

My dear Doctor:

Just after finishing a letter to you, I received yours of the 16th instant in which you say you had

(Testimony of Bernard Potter.)

hoped to be in my office by this date, but had been delayed.

You say that your Detroit business is still hanging fire but will have to let that go until you return. I do not quite understand what you mean, whether the unfinished business relates to the property settlement or not. I naturally assume, however, that you will have the whole thing thrashed out with Mr. Wheat before you come and will be ready to settle everything up, for the reason that naturally the divorce case will not be instituted until this is done. Your non-arrival before the fore part of June will not prejudice our interests in any way that I can see.

After you are served with a Summons and Complaint, it requires ten days before default can be entered and usually it requires three or four days after that before the matter can be heard and the interlocutory decree entered.

I think the above answers all the questions in your last letter. Am glad to know that I will see you before long.

Sincerely yours,

/s/ BERNARD POTTER.

BPSr:PW

Admitted in evidence Dec. 1, 1950.

(Testimony of Bernard Potter.)

Mr. Bouchard: You can put the other one in too without identification if you want to.

Mr. Flynn: All right. The next is dated July 7, 1937, from Mr. Potter to Mr. Miller.

The Court: It is received.

The Clerk: Exhibit F.

(The document above referred to was marked Respondent's Exhibit F for identification and received in evidence.) [51]

RESPONDENT'S EXHIBIT F

Potter & Potter

Attorneys at Law

Suite 814 Chester Williams Building

Los Angeles, California

July 7, 1937.

Dr. Jared H. Miller,
P. O. Lock Box #685,
Rochester, Minnesota.

My dear Doctor:

Your letter was received yesterday in which you stated that Mrs. Miller would meet her son in Salt Lake on the 8th and would return to Los Angeles on about the 1st of August.

I telephoned Mr. McCoy and he said that as soon as the 30 day period was up, after service of the Summons and Complaint on you, he would have the default entered. He was not sure just when the case could be set for hearing on account of the

(Testimony of Bernard Potter.)

courts usually being closed in August, but would communicate with the office immediately upon the setting of the case so that we could be present.

Whenever the case is set, you can be assured that either I or my son will be present to see that the property settlement agreement is approved by the court.

It is likely that I will be in Detroit about the 29th or 30th of July; however, when I know for certain, I will write you.

Hoping everything is going along fine with you, I remain

Your very truly,

/s/ BERNARD POTTER.

BP:B

Received in evidence Dec. 1, 1950.

Mr. Flynn: No further questions.

Cross-Examination

By Mr. Bouchard:

Q. I hate to cross-examine a lawyer, Mr. Potter—— A. Maybe it will make it easier.

Q. ——Especially one that has been practicing law since the year I was born. That is quite some time ago.

Mr. Potter——

The Court: That was a very important year.

(Testimony of Bernard Potter.)

Mr. Bouchard: Yes, it was.

Q. (By Mr. Bouchard): I understood from Judge McCoy's testimony that the financial part of this settlement was agreed on rather quickly after you had opened negotiations?

A. My recollection is—of course, that is fourteen years ago—that it was not very long. It did not take particularly long.

Q. And you started your negotiations some time along about October of 1936?

A. Yes, it was in the month of October.

Q. I understand from his testimony that the thing that took the most time was the division of this personal property that is set forth in Schedules A and B?

A. That did take up a lot of time. I wouldn't say that it took up most of the time because I had correspondence with [52] regard to it, which was the important thing.

Q. Of course, Dr. Miller was in the East during all the time these negotiations were going on, was he not?

A. I think all the time, that is my recollection.

Q. Nearly everything you represented him in here and your recommendations had to be transmitted to him and he took them up with his Detroit counsel, isn't that true? A. That is right.

I would like to say now that you have called attention to one thing that is a little different and that was the clauses that would be put in the agreement with reference to the disposition of the future

(Testimony of Bernard Potter.)

interest, that had to be gone over by attorney there because I was not familiar with the situation.

Q. The Detroit counsel was counsel for the mining company? A. That is right.

Mr. Bouchard: That is all.

Mr. Flynn: Your Honor, I have just one more question.

Redirect Examination

By Mr. Flynn:

Q. Mr. Potter, are you Dr. Miller's attorney at the present time?

A. I haven't been his attorney for I should say about ten years. He has other attorneys.

Q. And the Detroit counsel you have referred to in one [53] of these letters is Mr. Wheat?

A. Yes, Mr. Wheat.

Mr. Flynn: No further questions.

Mr. Bouchard: No questions.

The Court: The witness is excused.

(Witness excused.)

Mr. Flynn: The Respondent calls Dr. Miller. Whereupon,

JARED H. MILLER

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

The Clerk: Have a seat, sir, and state your name and address.

The Witness: My name is Jared H. Miller and the address is 390 Grove Street, Pasadena.

(Testimony of Jared H. Miller.)

Direct Examination

By Mr. Flynn:

Q. Dr. Miller, calling your attention to the property settlement agreement, dated June 15, 1937—

A. Yes, sir.

Q. Would you have signed that agreement unless you were sure that you would get a divorce from the then Mrs. Miller?

Mr. Bouchard: Just a moment. That is objected to as being incompetent, irrelevant and immaterial. The question is [54] not what he would have done, the question is what he did do. I think it is an extremely leading question, counsel.

Q. (By Mr. Flynn): Mr. Miller, at the time you signed the agreement on June 15, 1937, what was your understanding—

A. Thirty-six?

Q. Thirty-seven.

A. Yes.

Q. What was your understanding at the time regarding whether or not Mrs. Miller would give you a divorce?

A. Obtain one herself, you mean?

Q. That is right.

A. That was my definite understanding.

Q. Dr. Miller, please tell the Court in your own words just exactly what you mean by your definite understanding.

A. Well, let me go into the details briefly. The property settlement agreement for her support or alimony—whatever you want to call it—had been going on for some time, and at first she objected to getting a divorce or giving me one. I informed

(Testimony of Jared H. Miller.)

my counsel, Mr. Potter, that under no circumstances would I sign any agreement for her support unless it was understood that she would proceed with and get a divorce. I told him that he could convey that to Mr. McCoy, her counsel, which I understood later he did, and it has borne out the facts that those events all happened after a very short period of time one [55] after the other.

I know in one letter Mr. Potter wanted to know if I would be back in California at about a certain date in order to sign the property settlement agreement and that he would have a summons in the divorce case because in that event the divorce could be disposed of more quickly. I wrote an answer in which I think it is clear that I would be and I was, and all those events followed within a short time.

Mr. Flynn: No further questions.

Cross-Examination

By Mr. Bouchard:

Q. Mr. Miller, as I understand your testimony it is that these events with regard to the securing of the divorce and your signing of the property settlement were all done pretty quickly, is that so?

A. The dates speak for themselves.

Q. I want your testimony. It happened pretty quickly, didn't it?

A. It happened within a very short space of time I would say.

Q. And you knew before you came out here, I

(Testimony of Jared H. Miller.)

take it you had been advised by Mr. Potter, your counsel—— A. Yes.

Q. ——that Mrs. Miller was going ahead and procuring a divorce, did you not? [56]

A. I understood from my counsel and I relied on his statement, and I wouldn't have come and signed the agreement unless he would have had a verbal understanding with Mr. McCoy to that effect.

Q. You gained that information very shortly before you came out here and then you came out and signed the agreement?

A. That is in the letter.

Q. I am asking for your testimony. I will find out what is in the letter.

When you were advised by your counsel that Mrs. Miller was going ahead and procuring a divorce, you immediately came out here and signed the agreement and were very promptly served with a divorce, is that correct?

A. That is right.

Q. Now, Doctor, you are interested in the outcome of this particular case, are you not?

A. No, sir. No, I am not.

Q. Are you aware of the fact that this income that we are talking about if it is not taxable to Mrs. Miller that it is taxable to you?

Mr. Flynn: Objection, your Honor, that calls for a conclusion of the witness.

The Court: It is cross-examination.

Q. (By Mr. Bouchard): You understand that, don't you? [57]

(Testimony of Jared H. Miller.)

A. No, sir, I don't. I understand they might try to get it from me, but there would have to be a suit, and I am advised by very eminent people that they would be glad to fight it for me.

Q. In other words, you are aware of the fact that the Government can undertake to disallow the deductions to you if Mrs. Miller is successful in her case?

A. I understand that they will attempt to do that.

Q. Now, have the Government agents requested waivers of the statute of limitations from you?

A. I don't recall, but if they did it would be in the office of my tax assessor, Parker & Parker.

Q. Of this city?

A. Yes, sir, under your office.

Q. Isn't it a fact, sir, that you have given the revenue agent's office in this city, waivers of the statute of limitations involving the years 1945, and 1946?

A. I wouldn't want to testify to that until the records were examined because I don't know.

Q. You don't know? You have no recollection of either the revenue agent's office or your counsel requesting you to sign waivers of the statute of limitations?

A. I do have for signing for the State of California.

Q. You have no recollection of it though for the Federal Government? [58]

(Testimony of Jared H. Miller.)

A. I am sure I do not have.

Q. Have your counsel advised you that if Mrs. Miller is successful in her case before this Court that the Government will undertake, no doubt, to disallow the deductions to you?

A. My counsel——

Mr. Flynn: I object. It is immaterial and irrelevant and not proper cross-examination.

The Court: No, it isn't. If I have to explain it to you, it is to show interest on the part of the witness that you have called. It is perfectly all right.

The Witness: No, sir.

Q. (By Mr. Bouchard): You have never been advised of that? A. No, sir.

Q. You said you were represented by eminent counsel?

A. No, I said eminent counsel have advised me that if such were the case they would be glad to undertake my side of the suit, and I can tell who that was if you want to know.

Q. I think I do.

Q. You do? I am not sure that you do.

Mr. Bouchard: That is all.

Mr. Flynn: No further questions.

The Court: Anything further?

Mr. Bouchard: Nothing further.

Mr. Flynn: Nothing further. [59]

The Court: Dr. Miller, you are excused.

(Witness excused.)

The Court: You may file briefs and I will give

you forty-five days for the original briefs and thirty days for the reply briefs. The case is closed.

We will adjourn until Monday morning at 9:30 a.m.

(Whereupon, at 5:30 o'clock p.m., an adjournment was taken until 9:30 o'clock a.m., Monday, December 4, 1950.)

[Endorsed]: Filed September 12, 1949. [60]

[Title of Tax Court and Cause.]

Docket Nos. 23268, 24478

FINDINGS OF FACT AND OPINION

16 T.C. No. 124

Promulgated May 14, 1951.

Income — Agreement Incident to Divorce — Section 22(k).—Where all but some relatively unimportant provisions of a property settlement had been agreed upon during the time when the wife had no intention of obtaining a divorce, the agreement is not “incident to” a divorce within the meaning of section 22(k) merely because the wife, prior to the actual signing of the agreement, decided that she would try to obtain a divorce and her husband learned of her change of mind in regard to the divorce but was given no promise or assurance that she would proceed to obtain a divorce.

GEORGE BOUCHARD, ESQ.,

For the Petitioner.

WILLIAM B. FLYNN, JR., ESQ.,

For the Respondent.

The Commissioner determined a deficiency in income tax of \$1,207.00 for 1945, and one of \$995.60 for 1946. The only issue for decision is whether payments of \$6,300.00 received by the petitioner in each year are taxable to her under section 22(k).

Findings of Fact

The petitioner filed her individual income tax returns for the taxable years with the collector of internal revenue for the sixth district of California.

The petitioner has a son, born in 1911, a child of her first husband who died in 1913. She was married for the second time in 1921, and became the fifth wife of Jared H. Miller, 20 years her senior. They lived together for about 15 years. No children were born of their marriage.

The petitioner discovered in March, 1936, that Miller was being intimate with another woman in Rochester, Minnesota. The Millers resided in Fontana, California, where they had lived for a number of years. He confessed and they agreed that they would try to continue to live together and he would try to forget the other woman.

Miller had inherited from his fourth wife an undivided interest in some mining property in Michigan. He left Fontana on July 24, 1936, for a

visit to the mining properties, after which he planned to return to Fontana in September, 1936. He and the petitioner corresponded during his absence. Miller wrote to the petitioner late in September, 1936, informing her that he would not return to her and advising her to seek the advice of a lawyer in order to obtain a property settlement. Neither mentioned divorce to the other. She wrote to Miller in an effort to persuade him to return but never received another letter from him and thereafter they communicated only through attorneys.

The petitioner sought the advice of an attorney in October, 1936. She told him that she did not want a divorce but wanted a property settlement. Miller had been giving her an allowance of \$400.00 a month and continued those payments until the property settlement became effective. The attorney for the petitioner, and another Los Angeles attorney, acting for Miller, agreed, prior to March, 1937, upon all terms of a property settlement satisfactory to their clients, except as to the division of over 400 articles or groups of articles such as silver, furniture, draperies, pictures, jewelry, clothing, and other household furnishings and personal belongings, the division of which, by listing on two schedules to be attached to the settlement agreement, was not completed until May, 1937. The delay in reaching an agreement in regard to those personal items was due principally to the fact that Miller's attorney had to confer with him by mail.

Neighbors and friends of the petitioner kept asking her when her husband was going to return and this caused her to become increasingly embarrassed as time passed because she did not like to disclose that he had abandoned her. She told her attorney in late April, 1937, that she had decided to seek a divorce. Her attorney told the attorney representing Miller of her change of mind and the latter passed on the news to Miller late in April, 1937.

All terms of the property settlement had been agreed upon and the written instrument of settlement with complete schedules attached had been drawn up by the latter part of May, 1937, but the attorneys for the two spouses learned that Miller intended to come to Los Angeles in the near future and they decided to have the agreement signed when he got there. The agreement recites that it was entered into on June 15, 1937, and it was signed on that day. It recited that the parties were desirous of settling all of their property rights. Real and personal property owned by Miller was mentioned in the agreement, and it also stated that the petitioner had no property other than the personal property described in the schedule, and cash. Miller agreed to give to the petitioner a life interest in the property at Fontana, which they had occupied as a residence, to be used by her and the members of her immediate family as a home. He was to pay the taxes and other charges incident to ownership and protection of the property and the petitioner was to pay all expenses for the ordinary care and upkeep of the property.

Miller was to pay the petitioner \$6,300.00 a year as long as she lived. Total payments of \$3,650.00 were to be made for 1937. Provisions were made for the continuation of payments by Miller's estate if he predeceased the petitioner, and for payments to the petitioner's son and mother in case they survived the petitioner. More than 400 articles or groups of articles were listed in two schedules attached to the agreement, Miller was to have those listed in Schedule A and the petitioner was to have those listed in Schedule B. The agreement was to be in complete settlement of all property rights between the parties. They both agreed to perform whatever acts were necessary to carry it out. One paragraph of the agreement was as follows:

“This agreement shall not alter the relations of the parties hereto except with regard to their property rights; provided, however, that in the event that either party hereto shall obtain a divorce from the other, this agreement may be submitted to the court in which said divorce is obtained for approval.”

The agreement did not contain any provision, other than the above-quoted one, referring to the subject of divorce. No suggestion was ever made to the petitioner or her attorney that the property settlement agreement was contingent in any way upon her obtaining a divorce. There was no understanding or agreement between the petitioner and her husband at the time they entered into the property settlement agreement that it was contingent in any way upon her obtaining a divorce.

The attorney for the petitioner advised her to file her complaint for divorce while Miller was in California to sign the settlement agreement and could be served, thus avoiding delay in the final decree of divorce. She acted on that advice and filed her complaint for divorce in the Superior Court of California on June 23, 1937. A summons in that proceeding was served upon Miller in Los Angeles on that same day. Miller did not contest the divorce and an interlocutory judgment of divorce by default was entered on August 24, 1937. It recited that the property settlement agreement, dated June 15, 1937, had been filed as an exhibit in the proceeding and was "approved." A final judgment of divorce was entered on August 25, 1938, on a printed form on which only names and dates had been typed. The words printed on that form included the following: "That wherein said interlocutory decree relates to the property of the parties hereto, said property be and the same is hereby assigned in accordance with the terms thereof to the parties declared therein to be entitled thereto."

The petitioner and Miller entered into a supplemental property agreement on April 19, 1938, whereby the residence property at Fontana was to be conveyed to the petitioner absolutely and nine pieces of personal property theretofore awarded to the petitioner were to be surrendered by her to Miller. Otherwise, the terms of the original agreement were to remain in full force and effect. The supplemental agreement was never shown to the court in the divorce proceeding.

Miller, at times not shown, paid the fee of the petitioner's attorney for his services to her in connection with the settlement agreement and also paid his separate fee for his services in securing the divorce for her.

The petitioner reported as her only income for 1945, and 1946, the annual payments of \$6,300.00 received from Miller under the agreement of June 15, 1937. She reported no tax due and attached a statement showing the source of the funds and claiming that they were not taxable to her under section 22(k). The Commissioner, in determining the deficiencies, held that the payments were taxable to the petitioner under section 22(k).

OPINION

Murdock, Judge:

The settlement agreement in the present case was entered into in 1937. Section 22(k) became a part of the Internal Revenue Code in 1942. Thus, the petitioner and her husband did not have the new provisions of the law in mind at the time they entered into their agreement. It is not claimed that the decree of divorce imposed any obligation on Miller to make periodic payments to the petitioner. Section 22(k) provides that periodic payments received by a divorced wife, subsequent to the decree of divorce in discharge of a legal obligation which, because of the marital or family relationship is imposed upon or incurred by a husband under a written instrument incident to the divorce, shall be

includable in the gross income of the wife. The only difference between the parties is whether the written instrument under which the periodic payments were paid was "incident to" the divorce later obtained by the petitioner.

Not every agreement which is followed by a divorce is "incident to" the divorce within the meaning and intent of section 22(k). It is now pretty well recognized as a result of numerous decisions that a written instrument to be "incident to" a divorce must be part of an integral plan of the two spouses which included the obtaining of a divorce, the agreement under which the periodic payments are made, as one court has expressed it, must be a "part of the package of divorce." *Cox v. Commissioner*, 176 F. 2d 226, affirming 10 T.C. 955. The chief difficulty has been to determine from the facts in each individual case whether the necessary connection between the two exists. That connection is rather obvious where a divorce action had been commenced and the parties thought it was still pending at the time they signed the agreement. *George T. Brady*, 10 T.C. 1192. Sometimes for other reasons it may appear that the spouses entered into their agreement with a mutual understanding that it was to be followed promptly by a suit for divorce as a part of their entire plan. All of the surrounding circumstances convinced the court in the case of *Estate of Daniel G. Reed*, 15 T.C. 573, that both parties in making the property settlement were doing so with an implied understanding that it would be followed by a divorce and that it was not

something which they would have done had they not intended a divorce to follow. The fact that the two steps are a part of a single plan is clear where there is an express agreement or promise that one spouse is to sue for a divorce promptly following the agreement calling for the periodic payments. Robert Wood Johnson, 10 T.C. 647; Bertram G. Zilmer, 16 T.C. . . . , (Feb. 19, 1951). However, an agreement providing for periodic payments can not be said to be incident to a divorce later obtained where it was separate from the divorce and was arrived at for its own benefits even though shortly thereafter one spouse sued for divorce. Joseph J. Lerner, 15 T.C. 379. The fact that one spouse may be considering the possibility of a divorce is not enough to make the agreement "incident to" a divorce later obtained.

The present case is similar in a number of respects to the Lerner case. The petitioner and her husband had never discussed divorce and she had no intention of obtaining a divorce at the time they started, through their attorneys, to negotiate the property settlement. Furthermore, before the petitioner changed her mind and disclosed that fact to her attorney, the attorneys, with the approval of their clients, had agreed upon those terms of the property settlement under which the periodic payments here in question were made. If that situation had continued until they had signed the property agreement, this case would be indistinguishable from the Lerner case.

The difference is that while they were trying to divide up a lot of relatively small personal articles and before they signed the agreement, the petitioner told her attorney that she had changed her mind and wanted to obtain a divorce. She did not intend that information to be used in connection with the property settlement. Her attorney told Miller's attorney of her mental attitude and Miller learned of it. But it was merely information and not a promise or condition connected with the property settlement. However, Miller appeared as a witness for the Commissioner and testified that he had heard that Mrs. Miller was thinking of getting a divorce and he told his counsel to advise counsel for the petitioner that under no circumstances would he sign any agreement for her support unless it was understood that she would obtain a divorce. He testified, further, that he would not have come to California and signed the agreement without a verbal understanding with the attorney for the petitioner that she was going to obtain a divorce. Miller's attorney testified, as a witness for the Commissioner, that the property settlement was predicated upon the understanding that the petitioner would file a divorce suit. Neither Miller nor his attorney ever talked to the petitioner about a divorce and there is no reason to disbelieve her testimony to the effect that she never promised or agreed to obtain a divorce as a condition to the property settlement. Miller and his attorney did not deny that they had agreed upon all provisions

of the property settlement, except the items on Schedules A and B, months before the subject of divorce was ever mentioned. The attorney who represented the petitioner in the property settlement and later in the divorce never dealt directly with Miller in regard to the property settlement agreement. He denied that he had given any assurance to Miller's attorney prior to the signing of the property settlement agreement that the petitioner would obtain a divorce. He said he had never been asked to give any such assurance and had never had any discussion with Miller's attorney indicating that the property settlement was in any way connected with the divorce. He testified without equivocation that the property settlement agreement was entered into without any understanding or obligation that the petitioner would proceed with a divorce action. The Court feels that Miller and his attorney are mistaken and have testified more strongly for the Commissioner than the actual situation up to June 15, 1937, justifies.

Although the petitioner had told her attorney that she had decided to obtain a divorce, and although Miller knew that, nevertheless, she was free to make a new decision that she would not obtain a divorce. The property settlement was still separate in the mind of the petitioner from any action which she might subsequently take in regard to any divorce. She had sought the property settlement for its own benefits when she had no thought of divorce. She sought it because she wanted a settlement of her

property rights and funds on which to live. Miller was aware of that but, at the time he signed the agreement, was hoping that his wife would seek and obtain a divorce, yet he had merely his hope to rely upon. It had not been a foregone conclusion from the beginning that the wife would obtain a divorce, as was true in some of the cases cited above, and there was no mutual understanding between them on which he could rely or from which the petitioner might feel any obligation, moral or otherwise, impelling her to seek a divorce. In short, the property agreement in this case was not a part of an integral plan, which plan included an honest attempt on the part of the petitioner to obtain a divorce. It was not a part of the package of the divorce which was later obtained.

Decisions will be entered for the petitioner.

[U. S. Tax Court Seal.]

Served May 14, 1951.

The Tax Court of the United States
Washington

Docket No. 23268

CECIL A. MILLER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, promulgated May 14, 1951, it is

Ordered and Decided: That there is no deficiency in income tax for the year 1945.

Entered May 16, 1951.

Served May 17, 1951.

[Seal] /s/ J. E. MURDOCK,
Judge.

The Tax Court of the United States
Washington

Docket No. 24478

CECIL A. MILLER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, promulgated May 14, 1951, it is

Ordered and Decided: That there is no deficiency in income tax for the year 1946.

Entered May 16, 1951.

Served May 17, 1951.

[Seal] /s/ J. E. MURDOCK,
Judge.

[Title of Court of Appeals and Cause.]

T.C. Docket Nos. 23268 and 24478

PETITION FOR REVIEW

To the Honorable Judges of the United States
Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby petitions the United States Court of Appeals for

the Ninth Circuit to review the decisions entered by the Tax Court of the United States on May 16, 1951, that there are no deficiencies in respect of the income tax liability of Cecil A. Miller, the above-named respondent on review, for the taxable years 1945 and 1946. This petition for review is filed pursuant to the provisions of sections 1141 and 1142 of the Internal Revenue Code.

The respondent on review, Cecil A. Miller, is an individual residing at 174 South Mango Street, Fontana, California. Respondent's Federal income tax returns for the years 1945 and 1946, the taxable years here involved, were filed with the Collector of Internal Revenue for the Sixth District of California, whose office is located in Los Angeles, California, and within the jurisdiction of the United States Court of Appeals for the Ninth Circuit, where this review is sought.

Nature of Controversy

The sole question presented to and passed upon by the Tax Court contrary to the Commissioner's determination is whether there is includible in the taxpayer's gross taxable income for each of the years involved, under section 22(k) of the Internal Revenue Code, the sum of \$6,300.00 received by her from her former husband, Dr. Jared H. Miller, under the provisions of a property settlement entered into by the taxpayer and her former husband on June 15, 1937, prior to the institution by the taxpayer of a suit for divorce. The Court disagreed with the Commissioner's determination that the tax-

payer was liable for a tax on the payments so received by her and held that the settlement agreement was not "incident to" a divorce within the meaning of section 22(k) of the Internal Revenue Code, as a result of which holding decisions were entered on May 16, 1951, that there are no deficiencies in income taxes for the years 1945 and 1946.

On June 23, 1937, the respondent on review, Cecil A. Miller, filed, in the Superior Court of California, a complaint for a divorce from her husband, Jared H. Miller. A summons in the matter was served upon her husband in Los Angeles on that date. The complaint was heard on default and an interlocutory judgment of divorce was entered on August 24, 1937. A final judgment of divorce was entered on August 25, 1938.

Prior to the institution of her suit for divorce and after a rift had occurred between the respondent and her husband in respect of their marital relationship, Mrs. Miller and her husband had agreed upon the terms of a property settlement, the terms of which were embodied in a written instrument dated as of June 15, 1937, on which latter date the agreement was signed. The settlement agreement provided, among other things, that

"This agreement shall not alter the relations of the parties hereto except with regard to their property rights; provided, however, that in the event that either party hereto shall obtain a divorce from the other, this agreement may be submitted to the court in which said divorce is obtained for approval."

In her Federal income tax returns for the years 1945 and 1946 the taxpayer, the respondent on review, reported as her only income for those years the annual payments of \$6,300.00 received from her former husband under the agreement of June 15, 1937. She reported no tax due in respect of the receipt of such payments and claimed that such payments were not taxable to her under section 22(k) of the Internal Revenue Code. In his notices of deficiencies for the taxable years here involved the Commissioner held that the payments so received by Mrs. Miller were taxable to her under section 22(k). The Tax Court of the United States disagreed with the Commissioner's determination, holding that the agreement of June 15, 1937, was not "incident to" a divorce within the meaning of section 22(k) of the Internal Revenue Code, and as a result of such holding entered its decisions that there are no deficiencies in income tax for the years 1945 and 1946.

The two cases bearing the docket numbers mentioned above were consolidated for hearing before the Tax Court, and one opinion, 16 T.C. No. 124, was promulgated on May 14, 1951.

/s/ THERON L. CAUDLE,
Assistant Attorney General;

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

[Endorsed]: Filed Aug. 6, 1951, U.S.T.C.

[Title of Court of Appeals and Cause.]

T.C. Docket Nos. 23268 and 24478

NOTICE OF FILING PETITION
FOR REVIEW

To Mrs. Cecil A. Miller, 174 South Mango Street,
Fontana, California:

You are hereby notified that the Commissioner of Internal Revenue did, on the 6th day of August, 1951, file with the Clerk of the Tax Court of the United States, at Washington, D. C., a petition for review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 6th day of August, 1951.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue, Counsel for Petitioner on Review.

Service acknowledged.

[Endorsed]: Filed Aug. 21, 1951, U.S.T.C.

[Title of Court of Appeals and Cause.]

T.C. Docket Nos. 23268 and 24478

NOTICE OF FILING PETITION
FOR REVIEW

To George Bouchard, Esquire, 650 S. Spring Street,
Los Angeles 14, California:

You are hereby notified that the Commissioner of Internal Revenue did, on the 6th day of August, 1951, file with the Clerk of the Tax Court of the United States, at Washington, D. C., a petition for review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 6th day of August, 1951.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue, Counsel
for Petitioner on Review.

Service acknowledged.

[Endorsed]: Filed Aug. 21, 1951, U.S.T.C. .

[Title of Tax Court and Cause.]

ORDER ENLARGING TIME

On motion of counsel for petitioner on review, it is Ordered: That the time for preparation, transmission and delivery of the record sur petition for review of the above-entitled proceeding in the United States Court of Appeals for the Ninth Circuit is extended to Nov. 2, 1951.

[Seal] /s/ JOHN W. KERN,
 Chief Judge.

Dated Washington, D. C., August 31, 1951.

Served Sept. 5, 1951.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Ralph A. Starnes, Chief Deputy Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 30, inclusive, constitute and are all of the original papers and proceedings, including all original exhibits, 1 thru 5, and A thru F, admitted in evidence, on file in my office as the original and complete record in the proceedings before the Tax Court of the United States entitled: "Cecil A. Miller, Petitioner, v. Commissioner of Internal Revenue, Respondent," Docket Nos. 23268 and 24478, and in which the respondent in the Tax Court has initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 25th day of October, 1951.

[Seal] /s/ RALPH A. STARNES,
Chief Deputy Clerk, the Tax Court of the United
States.

[Endorsed]: No. 13145. United States Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Cecil A. Miller, Respondent. Transcript of the Record. Petition to Review a Decision of the Tax Court of the United States.

Filed October 29, 1951.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for
the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

T.C. Docket Nos. 23268 and 24478

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

CECIL A. MILLER,
Respondent on Review.

STATEMENT OF POINTS

Comes Now the Commissioner of Internal Revenue, petitioner on review in the above-entitled cause, by and through his attorneys, Theron L. Caudle, Assistant Attorney General, and Charles Oliphant, Chief Counsel, Bureau of Internal Rev-

enue, and hereby states that he intends to rely upon the following points in this proceeding:

The Tax Court of the United States erred:

1. In entering its decisions that there are no deficiencies in income tax for the years 1945 and 1946.

2. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner.

3. In holding and deciding that there was not includible in the taxpayer's gross taxable income for each of the years 1945 and 1946, under section 22(k) of the Internal Revenue Code, the sum of \$6,300 received by her from her former husband under an agreement entered into by the taxpayer and her former husband on June 15, 1937.

4. In failing and refusing to hold and decide, as was determined by the Commissioner, that there is includible in the taxpayer's gross taxable income for each of the years 1945 and 1946, under section 22(k) of the Internal Revenue Code, the sum of \$6,300 received by her from her former husband under an agreement entered into by the taxpayer and her former husband on June 15, 1937.

5. In holding that the agreement of June 15, 1937, between the taxpayer and her husband was not "incident to" a divorce within the meaning of section 22(k) of the Internal Revenue Code.

6. In failing and refusing to hold and decide that the agreement of June 15, 1937, was "incident

to" a divorce within the meaning of section 22(k) of the Internal Revenue Code.

7. In failing to find as a fact that the property settlement agreement between the taxpayer and her husband was predicated upon an implied understanding that the taxpayer, Mrs. Miller, would institute a suit for divorce.

8. In that its findings of fact, insofar as they are contrary to the Commissioner's determination, and its opinion are not supported by but are contrary to the evidence.

9. In that its opinion and its decisions are contrary to law and the Commissioner's regulations.

/s/ THERON L. CAUDLE,
Assistant Attorney General;

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Service acknowledged.

[Endorsed]: Filed Oct. 18, 1951, U.S.T.C.

[Title of Court of Appeals and Cause.]

T.C. Docket Nos. 23268 and 24478

STATEMENT RE DIMINUTION
OF RECORD

To the Clerk of the Tax Court of the United States:

Pursuant to the provisions of Rule 75(o) of the Federal Rules of Civil Procedure adopted by the United States Court of Appeals for the Ninth Circuit, you are hereby notified that the petitioner on review will not exclude or omit any part of the record in this proceeding.

/s/ THERON L. CAUDLE,
Assistant Attorney General;

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Service acknowledged.

[Endorsed]: Filed Oct. 18, 1951, U.S.T.C.

No. 13,145

**In the United States Court of Appeals
for the Ninth Circuit**

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CECIL A. MILLER, RESPONDENT

**ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX
COURT OF THE UNITED STATES**

BRIEF FOR THE PETITIONER

ELLIS N. SLACK,
Acting Assistant Attorney General.

**A. F. PRESCOTT,
CARLTON FOX,**
Special Assistants to the Attorney General.

FILED

JAN 28 1952

PAUL P. O'BRIEN
CLERK

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The June 15, 1938, agreement was a written instrument incident to the divorce which the taxpayer obtained from her husband on August 25, 1938, and the payments made by him to her thereafter during the taxable years 1945 and 1946, pursuant to the agreement, were includible in her gross income in those years under Section 22 (k) of the Internal Revenue Code. . . .	9
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**In the United States Court of Appeals
for the Ninth Circuit**

No. 13,145

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CECIL A. MILLER, RESPONDENT

*ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX
COURT OF THE UNITED STATES*

BRIEF FOR THE PETITIONER

OPINION BELOW

The Tax Court's findings and opinion (R. 100-111) are reported at 16 T.C. 1010.

JURISDICTION

The petition for review (R. 113-116) involves deficiencies in federal income taxes determined by the Commissioner against the taxpayer, Cecil A. (Anabel) Miller, for the taxable years 1945 and 1946. On February 28, 1949, the Commissioner mailed the taxpayer a notice of deficiency in such taxes for the taxable year 1945 in the amount of \$1,207 (R. 5-6), and on July 13,

1949, the Commissioner mailed the taxpayer a notice of deficiency in such taxes for the year 1946 in the amount of \$995.60 (R. 11-12). Within 90 days after February 28, 1949, and on May 24, 1949, the taxpayer filed a petition with the Tax Court of the United States for a redetermination of the deficiency for the taxable year 1945 (R. 3-7), and within 90 days after July 13, 1949, and on August 10, 1949, the taxpayer filed a petition with the Tax Court for a redetermination of the deficiency for the taxable year 1946 (R. 8-12), under Section 272 (a)(1) of the Internal Revenue Code. The decisions of the Tax Court that there are no deficiencies for the taxable years 1945 and 1946, were entered May 16, 1951. (R. 112, 113.) The two proceedings were consolidated for trial (R. 15), and are brought to this Court by a single petition for review, filed August 6, 1951 (R. 113-116), under the provisions of Section 1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

The taxpayer was divorced from her husband in an action for divorce instituted by the taxpayer against her husband on June 23, 1937, pursuant to a final decree of divorce entered on August 25, 1938. Periodic payments were received by her from her husband in the taxable years 1945 and 1946 in discharge of a legal obligation which, because of such relationship was incurred by him under a written instrument, denominated a property settlement agreement, entered into by them on June 15, 1937. The question is whether

such agreement was a written instrument "incident to such divorce," with the result that the payments made thereunder after the final decree of divorce was entered were includible in the taxpayer's gross income under Section 22(k) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

These are set out in the Appendix, *infra*.

STATEMENT

So far as material here, the Tax Court found the facts as follows (R. 101-111):

The taxpayer's first husband, by whom she had one son, born in 1911, died in 1913. In 1921 she married Jared H. Miller, who was 20 years her senior, and lived with him for about 15 years. They resided at Fontana, California. (R. 101.)

In March 1936, the taxpayer discovered that Miller was being intimate with another woman. He confessed and at first they agreed to try to continue to live together and to forget the other woman. (R. 101.)

Miller had inherited some mining property from his fourth wife. He left Fontana on July 24, 1936, to visit his mining property in Michigan, intending to return in September 1936, but wrote the taxpayer late in September that he did not intend to return, advising her to seek the advice of a lawyer in order to obtain a property settlement. The taxpayer wrote Miller in an effort to persuade him to return, but received no other letter from him and thereafter they communicated with each other only through attorneys. (R. 101-102.)

In October 1936, the taxpayer sought the advice of an attorney, telling him that she did not want a divorce but only a property settlement. In March, 1937, the taxpayer's attorney and the attorney for Miller had agreed upon all of the terms of the settlement. (R. 102.)

Late in April, 1937, the taxpayer decided to seek a divorce, and her attorney then told the attorney representing Miller of her change of mind. The latter passed on the news to Miller late in April, 1937. (R. 103.)

All of the terms of the property settlement had been agreed upon and the written instrument of settlement, with complete schedules, of the property which each was to receive, attached, had been drawn up by the latter part of May, 1937, but the attorneys for the two spouses learned that Miller intended to come to Los Angeles in the then near future and decided to have the agreement signed when he got there.¹ (R. 103.)

The agreement provided, among other things, that Miller was to pay the taxpayer \$6,300 a year as long as she lived, in quarterly installments, provision being made for the payment of that amount in such installments by his estate if he predeceased her. (R. 104.)

A paragraph in the agreement was as follows (R. 104):

This agreement shall not alter the relations of the parties hereto except with regard to their property rights; provided, however, that in the event that either party hereto shall obtain a divorce

¹ The agreement recited that it was entered into on June 15, 1937, and it was signed that day. (R. 103.)

from the other, this agreement may be submitted to the court in which said divorce is obtained for approval.

The agreement made no provision, other than the above-quoted paragraph, referring to such a divorce, and no suggestion was ever made to the taxpayer, or her attorney, that the property settlement agreement was contingent in any way upon her obtaining a divorce. There was no understanding between the taxpayer and her husband at the time they entered into the property settlement agreement that it was contingent upon her obtaining a divorce. (R. 104.)

On the advice of her attorney, the taxpayer filed a complaint for a divorce in the Superior Court of California on June 23, 1937.² (R. 105.)

Miller was served with a summons, but did not contest the divorce, and an interlocutory decree of divorce was entered by default on August 24, 1937. This decree recited that the property agreement of June 15, 1937, was "approved."³ (R. 105.)

A final judgment of divorce was entered on August 25, 1938, on a printed form on which only the names and dates had been typed.⁴ The words printed on that form included the following (R. 105):

² The complaint is Exhibit 3. (R. 51-56.) It is stated in paragraph IV thereof that taxpayer and her husband had entered into a property settlement agreement for the care and maintenance of the taxpayer during the rest of her natural life and that such agreement was acceptable to her and would be submitted to the court on the hearing of the action for its approval. Accordingly, the plaintiff prayed not only for the severance of the bonds of matrimony, but that the agreement be ratified and approved. (R. 55.)

³ The interlocutory decree of divorce is Exhibit 4. (R. 57-58.)

⁴ The final judgment of divorce is Exhibit 5. (R. 58-59.)

That wherein said interlocutory decree relates to the property of the parties hereto, said property be and the same is hereby assigned in accordance with the terms thereof to the parties declared therein to be entitled thereto.

On April 19, 1938, the taxpayer and Miller entered into a supplemental agreement wherein the residence property at Fontana, in which she had been given a life estate by the original agreement, was conveyed to her absolutely, and certain other personal property was surrendered to her by Miller. Otherwise the terms of the original agreement were to remain in full force and effect. The supplemental agreement was not shown to the court in the divorce proceeding.⁵ (R. 105.)

The taxpayer reported as her only income for 1945 and 1946 the annual payments of \$6,300 received from Miller under the agreement of June 15, 1937, but reported no tax due thereon, claiming that this amount was not taxable to her under Section 22(k) of the Internal Revenue Code. The Commissioner held that the amounts were taxable to her under that section and accordingly determined the deficiencies in question. (R. 106.)

The Tax Court held that the phrase "incident to" as used in Section 22(k) required that "a divorce must be part of an integral plan of the two spouses which included the obtaining of a divorce" (R. 107), and that (R. 111)—

In short, the property agreement in this case was not a part of an integral plan, which plan included

⁵ The supplemental property agreement was admitted in evidence as Exhibit 2. (R. 44-50.)

an honest attempt on the part of the petitioner to obtain a divorce. It was not a part of the package of the divorce which was later obtained.

STATEMENT OF POINTS TO BE URGED

The Tax Court erred:

(1) In holding that Section 22(k) required that, in order for the agreement therein mentioned to be “incident” to the divorce, it must be a part of an integral plan of the spouses which included the obtaining of the divorce.

(2) In holding that the evidence did not establish that the agreement in question was incident to the divorce which the taxpayer thereafter obtained from her husband.

SUMMARY OF ARGUMENT

The Commissioner contends that the Tax Court erred in holding the so-called property settlement agreement, which the taxpayer and her husband entered into on June 15, 1937, was not “incident” to the divorce she thereafter obtained from him, within the meaning of Section 22(k) of the Internal Revenue Code. The Commissioner’s contention is twofold: First, that the Tax Court misconstrued the section in holding that, for the agreement to be incident to the divorce, it must have been a part of an integral plan of the spouses which included the obtaining of a divorce. Second, the finding of the Tax Court that the agreement was not incident to the divorce is clearly erroneous (1) under the Commissioner’s interpretation of the statute, and (2) even under the Tax Court’s interpretation thereof. We discuss these contentions in the order stated under our Subpoints A and B.

A. The sole question in this case is whether the agreement was incident to the divorce, within the meaning of Section 22(k). The signal error of the Tax Court in holding that the agreement was not lies in the fact that it regarded the section as requiring that a divorce be anticipated, or contemplated, or mutually understood, or agreed to, and this before the financial terms of the agreement had been settled. The section itself does not so require, and such construction of it thwarts the Congressional purpose (1) to relieve the divorced husband of the tax upon income which he is required to pay his divorced wife as alimony or under an agreement in lieu thereof, and (2) to give the statute universal application, free from the vagaries of state law. It is well settled that the words of a statute must be given such meaning as will best implement its purpose. The interpretation of the section for which the Commissioner contends is designed to do that. So construed, the section requires no more than that the agreement be followed by a divorce. Several appellate courts have indicated that this is sufficient. Alternatively, the Commissioner contends that any evidence which shows a connection between the agreement and the divorce, including the fact that the parties contemplated a divorce, satisfies the requirement of such incidence.

B. Of course, if the incidence is established by the mere fact that the agreement is followed by a divorce, we have no problem here; for, under such interpretation of the section, the Tax Court's finding that there was no such incidence is clearly erroneous. The Tax Court's finding is, however, also clearly erroneous if the section is given a narrower interpretation; that is

to say, that it is held not necessarily to require that the parties entered into the agreement in anticipation or contemplation of divorce, or with the mutual understanding or agreement that one would follow. Here the incidence is established, among other things, by the fact that the agreement itself provides for its submission and approval by the divorce court in the event a divorce was obtained, and that it was accordingly submitted to the court and approved by it in the decree. Even so, the Tax Court's finding is also clearly erroneous under its own interpretation of the statute. The evidence establishes beyond the possibility of any question that, at least for six weeks prior to the execution of the agreement and while its terms had not been fully agreed upon by them, but only by their attorneys, both parties understood that the taxpayer would seek a divorce, as she did in fact. Thus, the evidence conclusively establishes that, at least during this period and thereafter until the divorce was obtained, both the taxpayer and her husband anticipated, contemplated, and mutually understood that a divorce would be obtained, if, indeed, they had not actually agreed thereto.

ARGUMENT

The June 15, 1938, Agreement Was a Written Instrument Incident to the Divorce Which the Taxpayer Obtained from Her Husband on August 25, 1938, and the Payments Made by Him to Her Thereafter During the Taxable Years 1945 and 1946, Pursuant to the Agreement, Were Includible in Her Gross Income in Those Years under Section 22 (k) of the Internal Revenue Code

It is the Commissioner's contention that the Tax Court erred in two respects, namely, first, in holding that the statute should be construed so as to require that

the agreement be a part of an integral plan of the spouses which included the obtaining of a divorce, and secondly, in holding that the evidence did not establish incidence between the agreement and the divorce. We consider first the holding of the Tax Court, which, as indicated, involves an erroneous construction of the statute, under our Subpoint A, and we shall then consider, under our Subpoint B (1), the sufficiency of the evidence to establish the incidence of the agreement to the divorce under our interpretation of the statute, and, under Subpoint B (2), the sufficiency of the evidence to establish such incidence, even under the Tax Court's interpretation thereof.

A. Section 22(k) does not require that, in order for the agreement to be "incident" to the divorce, it be a part of an integral plan of the spouses which included the obtaining of the divorce

So far as material here, Section 22(k) (Appendix, *infra*) may be skeletonized to show the five conditions to its application, i.e., to its requirement that the periodic payments therein specified made by a divorced husband to his divorced wife shall be included in her gross income, as follows:

(k) *Alimony, Etc., Income*.—In the case of a wife [1] who is divorced * * * from her husband under a decree of divorce * * *, [2] periodic payments * * * [3] received subsequent to such decree [4] in discharge of * * * a legal obligation which, because of the marital * * * relationship, is * * * incurred by such husband * * * under a written agreement [5] incident to

such divorce * * * shall be includible in the gross income of such wife, * * *.

It is conceded that the property settlement agreement entered into by the taxpayer and her husband on June 15, 1938, satisfies the first four requirements of the statute. In other words, the taxpayer was divorced from her husband under a decree of divorce and periodic payments were received by her from her divorced husband subsequent to such decree in discharge of his legal obligation which, because of the marital relationship, was incurred by him under a written instrument. Thus only the fifth requirement, that the agreement be incident to such divorce, is here in dispute.

The Tax Court held that the agreement was not incident to the divorce, which the taxpayer had obtained from her husband after the agreement was executed, solely because it concluded that, in order for the agreement to be such, it must have been a "part of an integral plan of the two spouses which included the obtaining of a divorce." (R. 107.) Thus, in applying this principle to the facts of the case as the Tax Court conceived them to be, it stated at the conclusion of its opinion that (R. 111):

It had not been a foregone conclusion from the beginning that the wife would obtain a divorce, as was true in some of the cases cited above, and there was no mutual understanding between them on which he [the husband] could rely or from which the petitioner [the taxpayer] might feel any obligation, moral or otherwise, impelling her to seek a divorce. In short, the property agreement in this case was not a part of an integral plan, *which plan*

included an honest attempt on the part of the petitioner to obtain a divorce. It was not a part of the package of the divorce which was later obtained. (Italics are supplied for emphasis.)

Otherwise stated, the Tax Court's theory of the statute—to which it here referred, as it had theretofore (R. 107), as the “package” theory—was that Section 22 (k) required, as a condition to the agreement's being held “incident” to the divorce, that it was entered into by the parties thereto in anticipation, or, as it has sometimes been stated, in contemplation of divorce. A perusal of the Tax Court's opinion makes it clear—a fact which we believe the taxpayer not only will not question, but, to the contrary, will readily concede—that this is the sole basis of the Tax Court's conclusion that the agreement here in question was not “incident” to the divorce, within the meaning of Section 22 (k).

Putting aside as irrelevant the Tax Court's evaluation of the evidence relating to such anticipation—which we shall, however, hereinafter under our Subpoint B-2 undertake to demonstrate to be clearly erroneous—a clear question of statutory construction is here presented, namely, whether the statute requires, as an absolute condition to the agreement's being incident to the divorce, that, at the time the agreement was conceived—and, in any event, thereafter until its terms were agreed upon—the parties anticipated, or contemplated, or understood, or agreed that a divorce would thereafter be obtained. And it is in the Tax Court's holding that such anticipation, contemplation, understanding, or agreement was an absolute prere-

quisite to the agreement's becoming incident to the divorce that the signal error of the Tax Court lies.

On the other hand, it is the Commissioner's contention that the incidence between the agreement and the divorce may be established not only by evidence of facts from which it appears that the parties intended that a divorce should be obtained, but, as here, from evidence of facts from which it appears that the agreement and divorce were so obviously related, both in point of time and circumstance, as, in combination, to effect a metamorphosis of the marital status of the parties into a divorce status, in the course of which, and as a direct result whereof, the husband's marital obligation, under applicable provisions of law, to maintain and support his wife, has been converted into a contractual one.

We are not unmindful of the fact that the statute may be given a much broader interpretation, as was suggested by the Court of Appeals in the First Circuit in the case of *Smith v. Commissioner*, decided December 10, 1951 (1952 C.C.H., par. 9104), where that court in this behalf said:

Our conclusion is reached even on petitioner's assumption that the phrase in Section 22 (k) "under a written agreement incident to such divorce" means that the agreement must be "incident to a divorce decree". We need not take issue with the petitioner on this point. See *Mahana v. United States*, 88 Fed. Supp. 285 [50-1 USTC ¶9164], certiorari denied 339 U.S. 978. Whether that is the correct construction of Section 22 (k) we do not undertake to decide. It is appropriate to add, however, that in view of the congressional purpose in Section 22 (k) to secure tax uniformity irrespec-

tive of variances in state laws, there is much to be said for reading the phrase “a written instrument incident to such divorce” as referring to the continuing status of the legal obligation to support the divorced spouse. See *Mertens, Law of Federal Income Taxation*, Vol. I, 1951 Cum. Pocket Supp. § 5.23 at pp. 107, 108.

See also *Mahana v. United States*, 88 F. Supp. 285 (C. Cls.), certiorari denied, 339 U.S. 978, where the court in this behalf said (p. 285):

We have quoted the section, and it requires only that there be a divorce, a trust, and the receipt from the trust of income which would have been taxable to the husband if it had not been made taxable to the wife by the section. As the plaintiff properly concedes, these conditions are fulfilled as to the yield of the 1923 trust.

In this view, the fact alone that the divorce follows the agreement is sufficient to invoke the statute, at least presumptively. Under such interpretation, the statute would be given its broadest significance and application. It would completely implement the Congressional purpose to relieve the husband of the tax burden, which had theretofore been cast upon him under the federal taxing statute, despite the conversion of his marital obligation under applicable state law to maintain and support his wife into a contractual one, attendant upon a change of his marital status into a divorce status, as a result of a decree of divorce.

We believe such broader interpretation of the statute to be the correct one, because it is the only one which fully implements the Congressional purpose thereby to relieve the husband of the tax on income which he is

required, either by the decree of divorce or by the agreement, to pay to his divorced wife in satisfaction of his decretorially imposed or contractually assumed continuing obligation to maintain and support her. No reason is perceived or has been suggested why such relief should not be granted to him or why the burden of the tax upon such income should not be imposed upon her, because the incidence of the agreement to the divorce is established only by the concurrence of the agreement and the divorce. In any event, no reason is perceived or has been suggested why such relief should not be granted to him, or why the burden of the tax should not fall upon her, merely because the parties to the agreement did not from the outset anticipate, or contemplate, or mutually understand, or agree that a divorce should be obtained. Both the House and Senate Reports emphasize the fact that the purpose of the statute was to effect a change in the law as a result of which the husband was relieved of the burden of the tax theretofore imposed upon him in respect of income, which, after a divorce, was required by him to be devoted to the maintenance and support of his former wife, either under the terms of the decree of divorce or under an agreement entered into between him and his wife prior to the divorce. The House Report, H. Rep. No. 2333, 77th Cong., 2d Sess., p. 46 (1942-2 Cum. Bull. 372, 409-410), initially explains this change in the law in general terms, as follows:

5. ALIMONY AND SEPARATE MAINTENANCE PAYMENTS

The existing law does not tax alimony payments to the wife who receives them, nor does it allow the

husband to take any deduction on account of alimony payments made by him. He is fully taxable on his entire net income even though a large portion of his income goes to his wife as alimony or as separate maintenance payments. The increased surtax rates would intensify this hardship and in many cases the husband would not have sufficient income left after paying alimony to meet his income tax obligations.

The bill would correct this situation by taxing alimony and separate maintenance payments to the wife receiving them, and by relieving the husband from tax upon that portion of such payments which constitutes income to him under the present law. This treatment is provided only in cases of divorce or legal separation and applies only where the alimony or separate maintenance obligation is discharged in periodic payments. Moreover, the portion of such payments going to the support of minor children of the husband does not constitute income to the wife nor a deduction to the husband. The same is true with regard to payments in discharge of lump sum obligations, even though made in installments.

Where the husband's alimony or separate maintenance obligation is discharged through periodic payments attributable to property in trust, life insurance, annuity or endowment contracts, or to any other interest in property, the wife is required to include such payments in gross income, whether they come from income or capital. However, in the case of trusts created prior to the divorce or separation and not included thereto, the wife is required to include in gross income only the amount of the income of the trust which she is entitled to receive and which, under existing law, would be taxed to

the husband. The bill excludes such amount from the gross income of the husband.

Thereafter, in the course of the detailed discussion of the technical provisions of this bill, the same report says, pp. 71-72 (1942-2 Cum. Bull. 372, 427-428):

SECTION 117. ALIMONY AND SEPARATE MAINTENANCE PAYMENTS

This section adds new subsections to sections 22 and 23, amends sections 22 (b) (2), 25 (b) (2) (A), 401 (a) (2) and 3797 (a) of the Internal Revenue Code, and adds a new section to supplement E of chapter 1 in order to provide in certain cases a new income tax treatment for payments in the nature of or in lieu of alimony or an allowance for support as between divorced or legally separated spouses. These amendments are intended to treat such payments as income to the spouse actually receiving or actually entitled to receive them and to relieve the other spouse from the tax burden upon whatever part of the amount of such payments is under the present law includible in his gross income. In addition, the amended sections will produce uniformity in the treatment of amounts paid in the nature of or in lieu of alimony regardless of variance in the laws of different States concerning the existence and continuance of an obligation to pay alimony.

Section 22, relating to the definition of gross income, is amended by inserting at the end thereof a new subsection designated “(k)”. This subsection applies only to a wife who is divorced or legally separated under a decree of divorce or of separate maintenance and to the husband from whom she is divorced or legally separated by such decree.

Periodic payments, whether or not made at regular intervals, received by the wife subsequent to the decree, in discharge of, or attributable to property transferred (in trust or otherwise) in discharge of, a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation are defined by section 22 (k) as gross income of the wife. This section applies only where the legal obligation being discharged arises out of the family or marital relationship in recognition of the general obligation to support, which is made specific by the instrument or decree.

The Senate Report, S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 83-84 (1942-2 Cum. Bull. 504, 568), makes the identical explanation.

In other words, in providing that the periodic payments in question must be “under a written instrument *incident* to such divorce” (italics supplied), Section 22(k) enjoins us merely to find a case where the agreement and the divorce have come together in such a way as, in combination, to settle the marital difficulties of the spouses—the divorce effecting a change in their marital status, and the agreement providing for a continuance of the support of the wife by the husband thereafter. This, we submit, is the plain, obvious and rational meaning of the statute, and therefore involves a correct definition of the word “incident” as used therein. Indeed, as indicated, it is the only construction of the section which fully implements the Congressional purpose to relieve the husband of the tax in respect of income which he is required to pay his di-

forced wife and, at the same time, to cast the burden of such tax upon her.

Sight should never be lost of the fact the statute is remedial in its nature and that it affects both spouses. There is, therefore, no room, on the one hand, for a strict construction of the section, and no room, on the other, for a liberal construction thereof. *Burnet v. Guggenheim*, 288 U.S. 280, 286. We must ascertain what the construction of this section "fairly should be." *White v. United States*, 305 U.S. 281, 292. And since, as we have said, it is remedial in its nature, it must of necessity be construed so as to effectuate its purpose. See *Taylor v. United States*, 3 How. 197; *United States v. Stowell*, 133 U.S. 1; *United States v. Hodson*, 10 Wall. 395; *United States v. Graf Distilling Co.*, 208 U.S. 198; *Farmers' Loan & Trust Co. v. Bowers*, 68 F. 2d 916 (C.A. 2d), certiorari denied, 293 U.S. 565, 296 U.S. 649, 299 U.S. 582.

But the construction which the Tax Court placed upon Section 22(k) would lead to the very opposite result. This must be avoided if a reasonable application can be given it consonant with the legislative purpose. "The key to the proper interpretation of the act of congress is its policy and purpose." *Mercantile Bank v. New York*, 121 U.S. 138, 154.

Thus it is not required that the narrowest technical meaning be given the words of a statute—even those in a criminal statute—in disregard of their context and in frustration of the obvious legislative intent (*United States v. Corbett*, 215 U.S. 233, 242), or that the lawmakers' will be disregarded (*United States v. Giles*, 300 U.S. 41, 48). This principle has more recently

been applied by the Supreme Court in the case of *Board of Governors v. Agnew*, 329 U.S. 441, where, in order to implement the purpose of Congress to prevent directors and officers of banks who are members of the Federal Reserve System from being partners or employees of any partnership "primarily" engaged in the underwriting business, the Court held that the word "primarily," as used in the applicable section of the Banking Act, was not to be narrowly construed to mean "first," "chief," or "principal," but should be given its secondary and broader meaning of "essentially," "fundamentally," in the sense of "substantially." In this connection it is to be noted that, on the authority of that case, this Court, in *Rollingwood v. Commissioner*, 190 F. 2d 263, similarly construed the same word when used in a taxing statute, because such construction alone fully implemented the Congressional purpose. Of course, the Supreme Court has repeatedly held this principle applicable to taxing statutes. See *Helvering v. Stockholms &c. Bank*, 293 U.S. 84, 93-94, where, quoting *Sacramento Nav. Co. v. Salz*, 273 U.S. 326, 329, the Court said:

The rule of strict construction is not violated by permitting the words of a statute to have their full meaning, or the more extended of two meanings. The words are not to be bent one way or the other, but to be taken in the sense which will best manifest the legislative intent.

Thus, in the *Stockholms &c. Bank* case, the Supreme Court held that, in order fully to implement the purpose of Congress, the word "person," as used in the

taxing Act there under consideration, included the United States.

The *Sacramento Nav. Co.* case, which, as stated, was cited by the Supreme Court in the *Stockholms &c. Bank* case, presented a question of statutory interpretation which is highly significant here. There the Supreme Court defined the word "vessel" in the phrase "vessel transporting merchandise," so as to include the combination of a vessel and a barge which the vessel was towing and which contained the merchandise that was being transported. The inclusion in the word "vessel" of the barge in combination with the vessel clearly indicates the length to which the Supreme Court considers the courts must go in order to implement the purpose of Congress. And in *United States v. Giles, supra*, the statute denounced as criminal one who with intent, etc., "makes a false entry." The Court held the statute broad enough to include the deliberate act of the defendant bank teller of withholding deposit slips for the purpose of concealing a shortage in his cash, from which a false entry by an innocent intermediary necessarily followed. For, as the Court said (pp. 48-49), it gave the words employed their "fair meaning"; that such holding was in accord with the evident intent of Congress, and to hold otherwise would "emasculate the statute—defeat the very end in view."

Even before the *Stockholm &c. Bank* case, the Supreme Court had repeatedly applied this principle in tax cases. Thus, in *Carbon Steel Co. v. Llewellyn*, 251 U.S. 501, 504, the Supreme Court construed the word "manufacturing" to include the activities of a corporation "furnishing" munitions to the British Govern-

ment, for whose manufacture the corporation had contracted. And, in *Worth Bros. Co. v. Lederer*, 251 U.S. 507, where the taxpayer contended that steel forgings were not “part of shells” in any practical or legal sense, because their development was so far short—80 per cent—of the point where they could be related to or combined with any other component of the shell structure, the Court, in answer, said (p. 510):

We reject the contention. Congress did not intend to subject its legislation to such artificialities and make it depend upon distinctions so refined as to make a part of a shell not the taxable “part” of the law.

Another example is in case of the “contemplation of death” section of the Code, which provides that there shall be included in the decedent’s gross estate the value of all transfers *made by him* in contemplation of his death. Thus, in *City Bank Co. v. McGowan*, 323 U.S. 594, 599, the Supreme Court said that it seemed to it it was “sticking in the bark” to say that, in the circumstances, the transfers were not within the section because Congress did not add a phrase to the effect that where a state court made the transfer, acting in lieu of the incompetent owner, such transfer should be governed by the statute.

It is no answer to our contention, that the word “incident” as used in Section 22(k) should be construed to mean the coming together of the agreement and the divorce, to say that such interpretation of the section deprives the word “incident” of any meaning. There may possibly be agreements obligating the husband to

support his wife from whom he is separated which are so far removed in point of time and circumstance from a subsequent divorce as to appear to be unrelated thereto. And it may be that, in such a case, other evidence is necessary to establish the incidence between the agreement and the divorce, than that a divorce was obtained after the agreement was executed. But it will be time enough to determine whether, in such a situation, Section 22(k) requires more proof than that the agreement was followed by a divorce, to establish such "incidence." See *Old Colony Tr. Co. v. Commissioner*, 279 U.S. 716, 731. Moreover, while ordinarily an agreement made after divorce does not fall within the purview of the statute (see *Cox v. Commissioner*, 176 F. 2d 226 (C.A. 3d); *Commissioner v. Walsh*, 183 F. 2d 803 (C.A. D.C.)), this is not necessarily so. An agreement made after a divorce has been granted may be incident thereto no less than an agreement made prior thereto. But the incidence of such an agreement must, of necessity, be established by evidence other than its execution after the divorce. For one thing, the divorce may terminate the husband's obligation to support his divorced wife. In such event, the agreement would be purely voluntary, and the payments made thereunder would be regarded as mere gifts. Or the question may arise as to whether the agreement is supplemental to an original agreement made prior to divorce, which is incidental thereto, or whether it is a substitute for such an agreement. See the decision of this Court in *Fairbanks v. Commissioner*, 191 F. 2d 680, as well as the First Circuit's decision in *Smith v. Commissioner*,

supra; and cf. *Murray v. Commissioner*, 174 F. 2d 816 (C.A. 2d).

If the foregoing explanation given of Section 22 (k) in the Congressional reports were the only explanation thereof, we would unhesitatingly say that nothing more is required to effect an incidence of the agreement to the divorce than that the agreement was followed by the divorce.

However, there is some indication in both reports, albeit unsatisfactory and inconclusive, that Congress did not intend to make such incidence the only condition to the application of the statute. This indication lies in the fact that both reports go on to state (H. Rep. No. 2333, *supra*, p. 72 (1942-2 Cum. Bull. 372, 428), and S. Rep. No. 1631, *supra*, p. 84 (1942-2 Cum. Bull. 504, 568)) :

This section does not apply to that part of any periodic payment attributable to any interest in the property so transferred, which interest originally belonged to the wife, unless she received it from her husband in contemplation of or as an incident to the divorce or separation without adequate and full consideration in money or money's worth, other than the release of the husband or his property from marital obligations.

Reference here is to that portion of Section 22 (k) which refers to periodic payments made by the divorced husband to his divorced wife indirectly in the discharge of his contractual obligation to maintain and support her, that is to say, to periodic payments which are "attributable to property transferred (in trust or otherwise)" in discharge of such obligation.

It will be noted that such an agreement is said to fall within the ambit of the statute either if it is made "in contemplation of" divorce, or if it is "an incident to the divorce." On the other hand, as we have already pointed out, the statute itself provides only that such an agreement must be "incident to such divorce"; it does not provide, in the alternative, that it may be made only "in contemplation" thereof.

Thus, the very best that may be said of the committees' explanation of the purpose of this portion of the section is that the agreement must be incident to the divorce is that Congress intended such contemplation to suffice to establish the incidence where it is not otherwise shown.

But it does not follow that, because incidence between the agreement and the divorce may be established by proof that a divorce was anticipated, such proof is indispensable to establish it. Thus, while in the case of *Izrastzoff v. Commissioner*, decided January 8, 1952 (1952 C.C.H., par. 9134), the Second Circuit rejected the taxpayer's contention that the Tax Court's findings were clearly erroneous, that the parties there had contemplated divorce when the agreement was executed, and for that reason sustained the Tax Court's decision, the court went on to say:

Moreover, we are disposed to accept the [Government's] argument that her intent is not the determinative factor. Even if she were completely immune from thoughts of an outcome which a large part of society accepts as the normal denouement of marital disruption, the evidence would still support the conclusion that the agreement

was "incident to" the divorce. There is no requirement in § 22(k) of positive proof that both parties jointly and positively anticipated legal divorce or separation at the moment they signed the agreement. As illustrated by this case, such a construction would force the Commissioner to rely on an interested party's recollection of her own state of mind of some thirty years past concerning negotiations in which she played no real part. See *Powell v. C.I.R.*, 1 Cir. 94 F. 2d 483, 486. It would make meaningless the concrete evidence of events and the agreement itself, which are far from mute in pointing to the connection between agreement and subsequent legal separation or divorce. Legislative emphasis upon a mutually coexistent intent for divorce is not to be assumed in the absence of an expressed requirement, particularly in view of the well understood danger that an appearance of collusion between the parties might prevent divorce in many jurisdictions. Such legislative history as is available stresses only the manifest fairness of charge to the wife and deduction by the husband of payments not only for alimony, but also for separate maintenance provisions "in the nature of or in lieu of alimony or an allowance for support." House Ways and Means Committee, 77th Cong., 2d Sess., Rep. No. 2333, pp. 46, 71, 72; Senate Finance Committee, 77th Cong., 2d Sess., Rep. No. 1631, pp. 83-85. Hence *Lerner v. C.I.R.*, 15 T.C. 379, 386, relied on by petitioner, goes overfar in intimating a requirement of anticipation of divorce by both parties at the time, although the decision is quite unexceptional, since there divorce was only a faint and undiscussed possibility and the agreement actually looked to the support of the children.

Here the Tax Court's conclusion of law is supported by both the showing of the parties' states of mind and the events and agreement itself. We need not attempt any final definition of "incident to," a phrase which courts have found difficulty in clarifying.³ For here the evidence, viewed either together or apart from that portion objected to by petitioner, seems quite clear that the agreement was "incident to" the divorce, whether or not both parties were actively planning such action at the moment they executed it. The proximity in time of the settlement and the institution of proceedings, Reid's efforts to collect evidence of his estranged wife's infidelities unexplainable save in the light of plans for legal action, the wife's relationship with the future correspondent, and the provisions for divorce incorporated in the agreement—all require the inference that execution of the agreement was based upon the contemplation of divorce as a real possibility and an intent that this agreement should become part of such an ultimate settlement between the parties. See *C.I.R. v. Murray*, 2 Cir., 174 F. 2d 816; *Blum v. C.I.R.*, 177 F. 2d 670.

³ Thus, "incident to" has been paraphrased as "in connection with," *Tuckie G. Hesse*, 7 T.C. 700, 704, *Robert Wood Johnson*, 10 T.C. 647, 652; "part of the package of the divorce," *Cox v. C.I.R.*, 3 Cir., 176 F. 2d 226, 229, *Lerner v. C.I.R.*, 15 T.C. 379, 386; "contemplated at the time of executing the agreement," *George T. Brady*, 10 T.C. 1192, 1197; "usually or naturally and inseparably depends upon, appertains to, or follows," Ballantine, Law Dictionary 623, 1930 Ed. We need hardly add that the result here is in harmony with these expressions.

It is thus seen that at least two circuits, the First and Second, as well as the Court of Claims, have regarded it as unnecessary to the establishment of such incidence that a divorce be contemplated at the time the agreement was first conceived, or at the time it was consummated, or that, as the Tax Court in the instant case said, the agreement must be a "part of an integral plan of the two spouses which included the obtaining of a divorce." (R. 107, 111.) See also in this connection the case of *Smith v. Commissioner*, *supra*, where the Court of Appeals for the First Circuit in this behalf said:

The petitioner cannot deny that the 1937 agreement was incident to the April 18, 1938 divorce decree because it was specifically incorporated in that decree.

In other words, the First Circuit regarded it as sufficient to establish such incidence that the agreement was specifically included in the decree.

Moreover, the additional purpose of Congress in enacting Section 22 (k), namely to establish a uniform basis of taxation freed from the impact of vagaries of state law, is obviously subserved by incidence of the agreement to the divorce, however it may be established, and does not require its establishment by proof that the parties anticipated the divorce at the time the agreement was entered into. A requirement that the incidence of the agreement to the divorce be established by proof that the parties anticipated the divorce would also unnecessarily restrict the purpose of Congress to give the section universal application, regard-

less of whether the courts in a given state could or could not by decree of divorce provide for the maintenance and support of the divorced wife thereafter.

The reliance of the Tax Court upon its own decisions, and particularly upon its decision in the case of *Lerner v. Commissioner*, 15 T.C. 379, appears to be misplaced. That case is now pending on the taxpayer's appeal in the Second Circuit, and with respect thereto that court has already in *Izrastzoff v. Commissioner, supra*, said, in the course of the portion of the opinion already quoted, that the Tax Court's decision therein goes overfar in indicating a requirement of anticipation of divorce by both parties at the time.

It would seem clear, therefore, that the Tax Court clearly erred in so interpreting Section 22 (k) as to require that the incidence of the June 15, 1950, agreement to the divorce could be established only by facts which showed that it was an integral part of a plan of the two spouses which included the obtaining of the divorce.

B. The Tax Court erred in holding that the evidence did not establish incidence between the agreement and the divorce

1. The evidence conclusively establishes such incidence under the Commissioner's interpretation of Section 22 (k)

Of course, if the incidence of the agreement to the divorce results from the mere fact that the divorce follows the agreement, we have no problem at all, for then it could not be denied that the statutory requirement of incidence is satisfied here. Such requirement

is, however, satisfied in this case, even if the Court regards such construction of the statute too broad, but concludes that reference in the decree to the agreement to say nothing of reference in the agreement to the decree, establishes the incidence. We do not see how it can be otherwise, for such reference obviously satisfies the "package" theory, excepting only in so far as it is thought, that, in addition, anticipation, or contemplation, or mutual understanding or agreement that a divorce would ensue is an indispensable element of proof to establish the incidence.

But, as indicated, Section 22 (k) does not specifically provide the character of proof required to establish such incidence; and, as we have seen, the Second Circuit has expressly said in the *Izrastzoff* case, *supra*, that there is no requirement in the section of positive proof that both parties jointly and positively anticipated legal divorce or separation at the moment (and, consequently, of course, at any time before) they signed the agreement. And, as we have also shown, such requirement would not only not implement the purposes which Congress intended to subserve in enacting the statute, but would so restrict its application as to thwart them to a large degree.

We have no doubt, therefore, that the incidence of the agreement to the divorce is here established not only by the fact that the agreement refers to the contingency of the divorce and requires its submission to the court for its approval in the divorce proceeding, but particularly by the fact that it was approved by the court in the proceeding.

But we are not satisfied to let the matter rest there. Loath as we are ever to challenge a finding of the Tax Court on the ground that it is clearly erroneous, we think the evidence in this case clearly shows that the taxpayer had decided to obtain a divorce more than six weeks prior to the time that the agreement was executed and that, at least during that period, it was mutually understood between the parties, acting through their respective attorneys, that a divorce was to be obtained. And that, we submit, should satisfy any possible requirement that they anticipated, or contemplated, or mutually understood, or agreed that a divorce was to be obtained.

We turn then to a discussion of this phase of the case.

2. The Tax Court's finding that the property agreement was not a part of an integral plan, which included an honest attempt on the part of the taxpayer to obtain a divorce, is clearly erroneous

At the outset, we are faced with the problem of determining just what the Tax Court meant when it said that "the property agreement in this case was not a part of an integral plan, which plan included an honest attempt on the part of the petitioner [taxpayer] to obtain a divorce." (R. 111.)

Assuredly, the Tax Court could not thereby have meant that the plan to obtain a divorce must have antedated the inception of the agreement. And, if the Tax Court did not mean to go that far, it might be thought that it regarded it as sufficient that the plan for divorce was conceived at any time during the

period the agreement was being formulated. But that clearly was also not the Tax Court's view.

What the Tax Court apparently meant was that the plan for divorce must have been mutually agreed upon during the period that plans for the separation were being formulated but before the terms of the agreement had been finally decided upon, particularly the amount of the periodic payments which the taxpayer was to receive from her husband not only prior, but also subsequent, to the divorce. Even then, the finding is that the attorneys for the parties had agreed upon the terms prior to March, 1937 (R. 102), but that the agreement itself with complete schedules attached had been drawn up only "by the latter part of May 1937," whereas the taxpayer had decided to obtain a divorce as early as the latter part of April, 1937, and had then so advised her attorney, Philbrick McCoy, who had in turn advised her husband's attorney, Bernard Potter, of that. (R. 103.) Not only that, but Potter had written Miller as early as May 3, 1937, indicating that the agreement was still in a formulative stage (Ex. D, R. 87-88) and that (R. 88)—

While I was talking with him [the taxpayer's attorney] over the phone he asked if it was likely that you would be in Los Angeles around the time the settlement was finally agreed upon as it would expedite matters with regard to the divorce; that is, if you were here you could be served with the papers and the matter disposed of quickly. I told him that I did not know positively whether you would be here or not, but I thought some mention had been made in one of your letters that there was such a possibility.

And again, on the 17th of May, 1937, Potter wrote Miller another letter (Ex. E, R. 89-90), wherein he said, among other things, as follows (R. 90):

After you are served with a Summons and Complaint, it requires ten days before default can be entered and usually it requires three or four days after that before the matter can be heard and the interlocutory decree entered.

Of course, the agreement was not signed until June 15, 1937, and Miller testified both on direct (R. 95-96) and on cross-examination (R. 96-99) that he would not have signed it except for his understanding that a divorce would be obtained. Now Potter had testified on direct examination as follows (R. 81-82):

By Mr. Flynn:

Q. Did you have any discussion with Mr. McCoy regarding whether or not the divorce would be contingent upon entering into the agreement?

A. I had many talks with Mr. McCoy about the whole matter and also about the question of the divorce. It was stated to me—stated to him by me that Dr. Miller would not consider entering into any property settlement whatsoever unless a divorce was procured, and that of course, it could not be procured by him, but by her. In fact, I have forgotten the date now, but the letter here will disclose that—that prior to the 15th day of June when this property settlement was executed and the decree of divorce or the divorce was filed on the 22nd or 23rd of the same month, along prior to that, and arrangement was made by which Mr. McCoy was to be paid for securing this

divorce. I think \$250.00 was paid down to him by Dr. Miller through me.

I don't know what that letter states. He calls attention to the fact—Mr. McCoy does—that there is due him \$250.00 for the divorce.

The whole property settlement was predicated upon the understanding that a divorce would be filed, a divorce suit would be filed.

Q. That was your understanding at that time?

A. It is not my understanding, my knowledge.

As against that, McCoy testified at great length that the divorce was not considered during the formulation of the agreement, but only after all of its terms had been agreed upon; that, in fact, the taxpayer did not want a divorce at first, changing her mind only in the latter part of April, 1937 (R. 19-21); his direct examination being concluded with the following summary (R. 23):

Q. As I understand your testimony, all of the financial terms of the property settlement agreement were agreed upon between you and counsel for Mr. Miller back in January or February of 1937, is that right?

A. That is right.

Q. And nothing was ever said to you by Mrs. Miller about a divorce until some time in the latter part of April or May of 1937?

A. Thereabouts.

Q. And neither Dr. Miller nor any of his attorneys ever indicated to you that there was any connection between the property settlement agreement and the divorce action?

A. None whatsoever.

And, on cross-examination, he testified (R. 25):

Q. Just prior to the filing of the divorce complaint, isn't it true that the agreement and the divorce were considered together in correspondence principally?

A. Quite likely, because by this time, if I remember correctly, I had informed Dr. Miller's attorney—I had referred in a letter as early as sometime in the latter part of April, that a divorce was in the wind, but by this time the property settlement was coming up to an end, and Mrs. Miller had advised me, as I just indicated, that she had concluded to get a divorce. Bernard Potter and I would stand on the street corner at Fifth and Spring any number of times during the lunch hour when we would meet and chew the fat about it, and then we would reduce the matters to correspondence. I don't doubt but that many times I referred to a divorce in the same letter that I was writing about the property settlement. I didn't keep two separate files in this respect.

Q. Weren't you at one time advised by Attorney Potter for Dr. Miller that unless Mrs. Miller signed the agreement that Dr. Miller would not go through with the divorce as planned?

A. That Dr. Miller wouldn't go through with the divorce? Dr. Miller had nothing to do with it. If he wanted to answer it and contest it, he might, but I don't recall any such conversation as that.

McCoy's testimony that he and Miller's attorney had agreed upon all of the terms of the agreement in February, or March, 1937, was obviously the basis of the Tax Court's finding that the attorneys for the parties had agreed on such terms prior to March, 1937. But

this does not explain why the terms of the agreement were not reduced to writing until the latter part of May. (R. 103.) That is explained in this record only by the fact that the correspondence between Miller and his attorney plainly indicates that the final terms of the settlement had not been agreed to by the parties, because this correspondence discloses that Miller did not indicate his assent thereto until sometime after May 1, 1937, that is, not until after the taxpayer had advised her attorney that she intended to get a divorce. (Ex. D, R. 87-88.)

It is, therefore, an inescapable inference, we submit—that is to say, one which the evidence compels—that, between the time the taxpayer told her attorney she had decided to get a divorce in the latter part of April, 1937, and the time the agreement was signed on June 15, 1937, the terms of the settlement agreement had not finally been agreed upon between the parties themselves, and further that during that period both the taxpayer and her husband anticipated, or contemplated, or mutually understood that there would be a divorce, if, indeed, they had not actually reached an agreement with respect thereto.

Nor is there anything in the taxpayer's testimony which in any way impairs this conclusion. Her testimony was that she had had no discussion with her husband personally about a divorce (R. 65); that, at the time the agreement was being negotiated, McCoy did not tell her that her husband wanted one (R. 67); that it was, however, before the agreement was signed, although not long before then, that she talked to McCoy about getting a divorce; and that, although she could

not fix the date, it was after the property settlement had been agreed upon (R. 67-68). She also summarized her direct testimony at its end, as follows (R. 68):

Q. And so far as you were concerned then I get it from your testimony that you and Dr. Miller never discussed the subject of a divorce? In fact, you never heard from him and that you were never advised by Mr. McCoy that Dr. Miller's attorneys had discussed the matter of divorce with him?

A. No.

It should be added that the taxpayer's cross-examination developed nothing beyond the fact that she could not fix the date of any occurrence during this period. (R. 68-72.)

Thus, obviously, she understood there was going to be a divorce, as did Miller. And, as obviously, it was their mutual—or shall we say, reciprocal—understanding with regard thereto which caused them to insert the provision in the agreement requiring its submission to the divorce court “in the event that either party hereto shall obtain a divorce from the other.” (R. 104.) Moreover, the ink was hardly dry upon the agreement before the taxpayer entered suit for divorce. In these circumstances, we submit, there was not the slightest justification for the Tax Court's disregarding or discrediting the testimony of either Miller or his attorney, as it said it had (R. 110), to the effect that, so far as he was concerned, the divorce was a condition to the execution of the agreement, if not from its inception, then thereafter during its formulation, and certainly before it was executed. It is elemental that the trier of the facts ought not to be heard to say that he believes, when he should

not have believed, or that he disbelieves when he should not have disbelieved. And, yet, that is precisely what the Tax Court did.

The thought that the taxpayer was “free to make a new decision,” presumably before the agreement was signed, as the Tax Court said she was (R. 110), is irrelevant. If she had changed her mind and had so advised her husband, he would not likely have executed the agreement. Nor is it relevant, if true, as the Tax Court further said it was, that the property settlement was separate in the taxpayer’s mind from any action she might subsequently take in regard to the divorce. (R. 110.) Of course, even after she had executed the property agreement, she could have gone back on her agreement to seek a divorce, and her husband would have been without a remedy. But she did not do that. Why didn’t she, if she did not at any time want a divorce? Obviously, because she had advised her husband through her attorney that she would get one, and could not thereafter in good conscience—or shall we say, in good grace—have refused to institute the action. Again, as we have seen, it is irrelevant, if true, as the Tax Court also said it was, that she sought the property settlement for its own benefits when she had no thought of divorce; that she sought it because she wanted a settlement of her property rights and funds on which to live. (R. 110-111.) In any event, the question is not what she sought originally, but what she agreed to eventually. Nor is there any basis for the Tax Court’s statement that Miller was aware of this, but at the time he signed the agreement was only hoping that she would get a divorce. (R. 111.) To the contrary, the record

clearly shows that he came back to California, not only to execute the agreement, but at the same time to be served with summons in the divorce action. (Ex. E, R. 89-90.) Moreover, sight should not be lost of the fact that the agreement itself provided for its submission to the divorce court in the event either party should obtain a divorce. Why should this have been put in the agreement, if not because the taxpayer had assured him (through her attorney) that she would get a divorce and the property agreement was entered into by both with a view to fixing his liability to maintain and support her after the decree had been obtained? We submit that is just what happened. It should be remembered that McCoy had testified to the effect that, from the time he had advised Miller's attorney of the taxpayer's decision to obtain a divorce, the property agreement and the prospective divorce were considered together; that he and Potter had stood on the street corner and talked about both "any number of times"; that they would then reduce their discussion to correspondence, and that he had no doubt many times referred to the divorce in the same letter that he was writing about the property settlement. (R. 25.)

The factual conclusion of the Tax Court—insofar as it is such—is, therefore, clearly erroneous, and should not be permitted to stand, that the property settlement was not a part of an integral plan of the taxpayer and her husband, which included the obtaining of a divorce.

CONCLUSION

For the reasons stated, the decision of the Tax Court should be reversed.

Respectfully submitted,

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JANUARY, 1952.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

* * * * *

(k) [as added by Sec. 120(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Alimony, Etc., Income*.—In the case of a wife who is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, periodic payments (whether or not made at regular intervals) received subsequent to such decree in discharge of, or attributable to property transferred (in trust or otherwise) in discharge of, a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation shall be includible in the gross income of such wife, and such amounts received as are attributable to property so transferred shall not be includible in the gross income of such husband. This subsection shall not apply to that part of any such periodic payment which the terms of the decree or written instrument fix, in terms of an amount of money or a portion of the payment, as a sum which is payable for the support of minor children of such husband. In case any such periodic payment is less than the amount specified in the decree or written instrument, for the purpose of applying the preceding sentence, such payment, to the extent of such sum payable for such support, shall be considered a payment for such support. Installment payments discharging a part of an obligation the principal sum of which is, in terms of money

or property, specified in the decree or instrument shall not be considered periodic payments for the purposes of this subsection; except that an installment payment shall be considered a periodic payment for the purposes of this subsection if such principal sum, by terms of the decree or instrument, may be or is to be paid within a period ending more than 10 years from the date of such decree or instrument, but only to the extent that such installment payment for the taxable year of the wife (or if more than one such installment payment for such taxable year is received during such taxable year, the aggregate of such installment payments) does not exceed 10 per centum of such principal sum. For the purposes of the preceding sentence, the portion of a payment of the principal sum which is allocable to a period after the taxable year of the wife in which it is received shall be considered an installment payment for the taxable year in which it is received. (In cases where such periodic payments are attributable to property of an estate or property held in trust, see section 171(b).

(26 U.S.C. 1946 ed., Sec. 22.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.22(k)-(1). *Alimony and Separate Maintenance Payments—Income to Former Wife.*—(a) *In general.*—Section 22(k) provides rules for treatment in certain cases of payments in the nature of or in lieu of alimony or an allowance for support as between spouses who are divorced or legally separated under a court order or decree. For convenience, the payee spouse will hereafter in this section of the regulations be referred to as the “wife” and the spouse from whom she is di-

vorded or legally separated as the "husband". See Section 3797(a) (17).

In general, section 22(k) requires the inclusion in the gross income of the wife of periodic payments (whether or not made at regular intervals) received by her after the decree of divorce or of separate maintenance. Such periodic payments may be received from either of the two following sources:

(1) In discharge of a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by the husband, or

(2) Attributable to property transferred (in trust or otherwise) in discharge of a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by the husband.

The obligation of the husband must be imposed upon him or assumed by him (or made specific) under either of the following:

(1) A court order or decree divorcing or legally separating the husband and wife, or

(2) A written instrument incident to such divorce or legal separation.

The periodic payments received by the wife attributable to property so transferred and includible in her income are not to be included in the gross income of the husband. See also section 29.171-1 in cases where such periodic payments are attributable to property held in trust.

The purpose and effect of section 22(k) may be illustrated, in general, by the following examples, in which it is assumed that the husband and wife make their income tax return on the calendar year basis:

Example (1). W sues H for divorce in 1942. The court awards W temporary alimony of \$25 a week pending the final decree. On September 1, 1942, the court grants W a divorce and awards her \$200 a month permanent alimony. No part of the \$25 a week temporary alimony received prior to the decree is includible in W's income under section 22(k), but the \$200 a month received during the balance of 1942 by W is includible in her income for 1942. Under section 23(u), H is entitled to deduct such \$200 payments from his income.

Example (2). W files suit for divorce from H. In consideration of W's promise to relinquish all marital rights and not to make public H's financial affairs, H makes a legally binding promise in writing to W to pay to her \$200 a month if a final decree of divorce is granted without any provision for alimony. Accordingly, W does not request alimony and no provision for alimony is made under a final decree of divorce entered prior to 1942. During 1942, H pays W \$200 a month, pursuant to the promise. The \$2,400 thus received by W is includible in her gross income under the provisions of section 22(k). Under section 23(u), H is entitled to a deduction of \$2,400 from his gross income.

Example (3). H and W enter into an antenuptial agreement, under which, in consideration of W's relinquishment of all marital rights (including dower) in H's property, and, in order to provide for W's support and household expenses, H promises to pay W \$200 a month for her life. Ten years after their marriage, W sues H for divorce but does not ask for or obtain alimony because of the provision already made for her support in the

antenuptial agreement. Likewise, the divorce decree is silent as to such agreement and H's obligation to support W. Section 22(k) does not apply to such a case. If, however, the decree were modified so as to refer to the antenuptial agreement, or if, at the time of the divorce, reference had been made to the antenuptial agreement in the court's decree or in a written instrument incident to the divorce, section 22(k) would require the inclusion of the payments received by W after the decree in her income for taxable years beginning after December 31, 1941. (As to including such payments in the wife's income, if made by a trust created under the antenuptial agreement, regardless of whether referred to in the decree or a later instrument, see section 29.171-1.)

Section 22(k) applies only where the legal obligation being discharged arises out of the family or marital relationship in recognition of the general obligation to support, which is made specific by the instrument or decree. Thus, section 22(k) does not apply to that part of any periodic payment which is attributable to the repayment by the husband of, for example, a *bona fide* loan previously made to him by the wife, the satisfaction of which is specified in the divorce decree as a part of the general settlement between the husband and wife.

Periodic payments are includible in the wife's income under section 22(k) only for the taxable year in which received by her. As to such amounts, the wife is to be treated as if she makes her income tax returns on the cash receipts and disbursement basis, regardless of whether she normally makes such returns on the accrual basis. * * *

No. 13,146

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for the Ninth Circuit**

NATIONAL LABOR RELATIONS BOARD, PETITIONER

v.

**GEORGE NOROIAN AND ARCHIE NOROIAN, INDIVIDUALLY
AND AS CO-PARTNERS D/B/A GEORGE NOROIAN COM-
PANY, RESPONDENTS**

MEMORANDUM IN SUPPORT OF MOTION FOR ENTRY OF DECREE

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FILED

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PANY, RESPONDENTS

MEMORANDUM IN SUPPORT OF MOTION FOR ENTRY OF DECREE

The Board's motion for entry of decree is based upon the alternate grounds: (1) that there are no contestable issues before this Court, in view of respondents' failure to file exceptions to the Intermediate Report, and (2) that the findings upon which the order is based are fully supported by substantial evidence. In presenting the first ground, the Board is not unmindful of this Court's recent decision in *N. L. R. B. v. Red Spot Electric Company* (No. 12804 decided June 20, 1951) where District Judge Fee, speaking for the Court,¹ denied such a motion but granted a decree after a review of the record. In view of the fact that this Court, like every other

¹ Judge Pope concurred specially, stating a position which, as appears below, we respectfully submit is the correct one.

Court of Appeals in which such a motion has been made,² had previously granted such a motion in *N. L. R. B. v. Rico*, No. 12359, and had, as we thought, fully endorsed the principles underlying such procedure in the more recent case of *N. L. R. B. v. Townsend*, 185 F. 2d 378, certiorari denied, 341 U. S. 909, the Board in the *Red Spot* case did not file an extensive brief in support of its motion. We therefore respectfully request that this Court reconsider the views expressed in the *Red Spot* decision in the light of the considerations set forth in Point I below. Should this Court adhere to the *Red Spot* decision, however, we show in Point II that here, as in that case, examination of the record discloses substantial support for the findings of the Board.

² See *N. L. R. B. v. Hill Transportation Co.*, (C. A. 1, No. 4395); *N. L. R. B. v. Dairy Center, Inc.*, (C. A. 1, No. 4476); *N. L. R. B. v. Israel Putnam Mills, Inc.*, (C. A. 2, January 10, 1950); *N. L. R. B. v. Vosburgh Company, Inc.*, (C. A. 2, January 8, 1951); *N. L. R. B. v. Truck Drivers Local Union No. 375, etc.* (C. A. 2, March 5, 1951); *N. L. R. B. v. Bergnes*, (C. A. 2, June 4, 1951); *N. L. R. B. v. Gunn*, (C. A. 3, No. 9822); *N. L. R. B. v. Star Metal Mfg. Co.*, (C. A. 3, No. 9981); *N. L. R. B. v. Cordele Manufacturing Co.*, 172 F. 2d 225 (C. A. 5); *N. L. R. B. v. Davis*, 172 F. 2d 225 (C. A. 5); *N. L. R. B. v. Amory Garment Company*, 24 LRRM 2274 (C. A. 5); *N. L. R. B. v. Woodruff*, (C. A. 5, No. 12850); *N. L. R. B. v. The American Thread Company*, (C. A. 5, No. 13586); *N. L. R. B. v. Lancaster Foundry Corporation*, (C. A. 6, No. 10847); *N. L. R. B. v. Ullin Box and Lumber Co.* (C. A. 7, No. 9588); *N. L. R. B. v. Hasselberg*, (C. A. 7, No. 10354); *N. L. R. B. v. Burk*, 177 F. 2d 1021 (C. A. 8); *N. L. R. B. v. Griffin-Goodner Grocery Co., Inc.*, 170 F. 2d 152 (C. A. 10); *N. L. R. B. v. International Union of Mine, Mill & Smelter Workers, etc.*, (C. A. 10, No. 4174).

In view of respondent's failure to file exceptions to the recommended order, there are no litigable issues for the Court to consider. The Court should, therefore, enter a decree enforcing the Board's order

Following the issuance of a complaint charging respondents with unfair labor practices, respondents were accorded the customary hearing before a Trial Examiner. The Examiner thereupon issued his "Intermediate Report and Recommended Order," dismissing certain allegations of the complaint but sustaining other allegations and recommending that respondents undertake certain remedial action. No exceptions were filed to the report and recommendations of the Trial Examiner. Accordingly, the Board, as required by the Act,³ adopted the recommended order as its own.

We respectfully submit that just as the statute, when no exceptions have been filed to an Intermediate Report, requires the Board to enter the order based thereon without re-examining the record, so the statute contemplates that in such a case the Court shall enter a decree, treating the failure to file exceptions to the Intermediate Report as, in essence, a consent to the entry of the order by the Board, and reviewing the record only "for the purpose of determining that the

³ Section 10 (c) provides in part as follows: "* * * [the examiner] shall issue and cause to be served on the parties to the proceeding a proposed report, together with a recommended order, which shall be filed with the Board, and if no exceptions are filed within twenty days after service thereof upon such parties, or within such further period as the Board may authorize, such recommended order shall become the order of the Board and become effective as therein prescribed."

Board had jurisdiction * * * and that it has not ‘traveled outside the orbit of its authority’ ” (Pope, C. J., concurring in the *Red Spot* case, *supra*. This result follows, we believe, from a consideration of the role of exceptions in the administrative proceedings and from the express provisions of the statute itself.

1. *Summary statement of Board's position.*—Before developing in detail the reasons and authorities supporting the Board's view, it might be well briefly to summarize the Board's position and to discuss the objections thereto raised in the majority opinion in the *Red Spot* case. The Board's position rests primarily upon Section 10 (e) of the Act which provides that when the Board petitions for enforcement of an order, “no objection that has not been urged before the Board, its member, agent, or agency shall be considered by the court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances.” In a case where no exceptions have been filed to the report and recommendations of the Trial Examiner, and his recommended order has automatically become the order of the Board we submit, and the cases cited in note 2, *supra*, hold, that Section 10 (e) contemplates judicial enforcement of the order. In the *Red Spot* case, however, the majority opinion suggests certain considerations which in the Court's view militated against this result. While these considerations will be more fully discussed *infra*, they may be summarized briefly as follows:

a. The Court suggests (*Red Spot* opinion, n. 3) that if “objections were made by [respondent] before the

trial examiner, an agent of the Board,” Section 10 (e) does not preclude judicial consideration of the objection. But we respectfully submit that where the objection is not preserved in exceptions, it must be treated as abandoned, and entitled to no greater weight than if it had never been advanced at all (*infra*, pp. 9-12).

b. The Court’s opinion in *Red Spot* further suggests that to grant the Board’s motion and to enforce the order summarily involves a “mechanistic approach” which leaves the Court in the position of merely rubber-stamping the Board’s order. The Court states that “if mechanical sanctions were required, these could have been provided without the necessity of appeal to the courts.” The Board respectfully submits that this is not an accurate appraisal of the suggested procedure. It is true that in our view, as we argue more fully below, the absence of exceptions indicates the respondent’s acquiescence in the propriety of the Board’s findings and order in the form recommended by the trial examiner and constitutes an abandonment of objections thereto. But there remain at least three clear areas of judicial consideration in which the court may be called upon to act. These are: (1) questions of the Board’s jurisdiction; (2) whether it is acting clearly outside the orbit of its authority; and (3) whether the respondent’s failure to file exceptions is excused by “extraordinary circumstances” (Section 10 (e)).

As to the first, this Court held in *N. L. R. B. v. Townsend*, *supra*, as there suggested by the Board, that a respondent is never precluded from contesting

before the Court the agency's ultimate finding that his activities affect commerce,⁴ although his failure to file exceptions to the subordinate facts upon which the ultimate finding of commerce was based precluded an inquiry as to the propriety of such subordinate findings (185 F. 2d at page 381, n. 4).⁵ As to the second, if, for example, the Board in its order purported to remedy violations of some other federal statute, or otherwise acted clearly outside the orbit of its authority under the National Labor Relations Act, the court could unquestionably decline to enforce the order.⁶ The third area of judicial consideration in which reviewing courts may be called upon to act likewise needs little discussion. A finding of "extraordinary circumstances" which excuse the failure or neglect to file exceptions before the Board brings into play the full reviewing powers of the court.

For these reasons, because the powers of the reviewing court may be invoked in proper cases even though no exceptions have been filed, mechanical sanctions were not provided by Congress.

c. The opinion in the *Red Spot* case suggests that the reviewing court's powers and duties are analogous to the practice of trial courts, reflecting ancient

⁴ In the instant case the undisputed facts establish that respondents are engaged in interstate commerce within the jurisdiction of the Board. See Intermediate Report, p. 3.

⁵ But cf. *Halsted v. Securities and Exchange Commission*, 182 F. 2d 660, 669 (C. A. D. C.), certiorari denied, 340 U. S. 834, where the court held that the failure to object to the Commission's jurisdiction constituted a waiver of the objection to jurisdiction.

⁶ No such contention has been or could be advanced here as the Board's action is patently within the general scope of its authority.

chancery procedure, to take proofs before decree, and to the custom of appellate courts to notice obvious error. The Board respectfully submits that insofar as analogy may be drawn to equity practice, the rule applicable here is that which precludes appellate review of a Master's findings to which, prior to confirmation, no exceptions were filed. See *Kinsman v. Parkhurst*, 18 How. 289, 294-295; *Medsker v. Bonebrake*, 108 U. S. 66, 71; *Sheffield, etc. R. Co. v. Gordon*, 151 U. S. 285, 290; *Otis Elevator Co. v. Pacific Fin Corp.*, 68 F. 2d 664, 670 (C. A. 9). But quite apart from such rule, the chancery analogy is not apposite here because "judicial review of findings of trial courts does not have the statutory or constitutional limitations on judicial review of findings by administrative agencies" (*United States v. Gypsum Co.*, 333 U. S. 364, 395). Thus, the Supreme Court has observed that "except when the Constitution requires it, judicial review of administrative action may be granted or withheld as Congress chooses" (*Estep v. United States*, 327 U. S. 114, 120), and that "in awarding a review of an administrative proceeding, Congress has power to formulate the conditions under which resort to the Courts may be had" (*American Power Co. v. Securities and Exchange Commission*, 325 U. S. 385 389). To the same effect, see *Oklahoma v. Civil Service Commission*, 330 U. S. 127, 137. This principle is implicit in *N. L. R. B. v. Cheney California Lumber Co.*, 327 U. S. 385, 388, where the Supreme Court recognized Section 10 (e) of the National Labor Relations Act as a "limitation which Congress has placed upon the powers of the Courts

to review orders of the Labor Board," and was expressly recognized in a comparable situation in *Todd v. Securities and Exchange Commission*, 137 F. 2d 475, 478, where the Sixth Circuit stated:

The Commission was established by congressional enactment, and the right to review its order likewise is given by the Congress. The conditions under which the right may be exercised are within the power of the Congress to define, and one condition is that any question relied on in this Court must have been urged before the Commission.

d. The majority opinion in *Red Spot* suggests that the amendments to the National Labor Relations Act and the Administrative Procedure Act have broadened the areas of judicial review of Board orders. As we discuss more fully (*infra*, pp. 15-23), we believe that those statutes broaden the scope of review when the courts are appropriately exercising reviewing powers, but do not grant power to review any action which prior to those statutes had not been subject to review at all.⁷

With this brief survey of the Board's position, and the points brought into issue by the *Red Spot* opinion, we turn to a somewhat fuller development of the reasons underlying the Board's view that in the absence of exceptions a decree should be entered enforcing the

⁷ The majority opinion in the *Red Spot* case in declining to follow *N. L. R. B. v. Cheney California Lumber Co.*, 327 U. S. 385, states that the opinion in that case is "subject to the change of the statutes." As Judge Pope observed in his concurring opinion, the *Cheney* opinion relies exclusively on the language of Section 10 (e) which was unaffected by the subsequent amendments to the Act.

order of the Board. As has been stated (*supra*, p. 4), the Board believes that this position finds support in general principles of law governing the role of exceptions in administrative procedure as well as in the governing statutory provisions, viewed in the light of their legislative history and controlling judicial interpretation.

2. *Role of exceptions in administrative process.*—

The purpose and office of a statement of exceptions in an orderly scheme of administrative procedure are, of course, well recognized. In an administrative agency like the Board, where the facts are heard in the first instance by a trial examiner, a statement of exceptions serves to call to the attention of the Board itself the specific objections which a respondent may have to the decision of the trial examiner. This is obviously a logical procedure. Parties in the first instance may contend vigorously over issues, admissibility of evidence, etc., but, after the trial examiner's resolution of the conflict in an intermediate report, may conclude that only certain issues remain which are worthy of further contest. Or, the respondent may feel satisfied that the decision though unfavorable, is a proper one, particularly where, as here, respondent succeeded in securing the dismissal of a portion of the complaint. Consequently, where no exceptions are filed to an intermediate report, and there is no showing of extraordinary circumstances which excuse the failure to file exceptions, it is a rational inference that the party who will be adversely affected by the recommended order acquiesces therein. In these circumstances, it would serve no useful pur-

pose to require the Board or the Court to review the entire record. Indeed, such a requirement would be manifestly unreasonable and would serve only to consume the time and effort of both the Board and the Court to decide issues no longer in dispute. The same is true where a party decides to litigate further only certain adverse findings or conclusions, having no objections to the remainder of the intermediate report. Here, too, no useful purpose is served in requiring the Board or the Court to review issues no longer in dispute.

Moreover, since the failure to file exceptions is in substance an agreement that the court may "enter judgment on consent" (*N. L. R. B. v. Cheney California Lumber Co.*, 327 U. S. 385, 389), we submit that such failure should be given the same effect as a stipulation consenting to the entry of a decree. Such stipulations, "favored in law," have been accepted as relieving the Board of making findings of fact with respect to unfair labor practices (*N. L. R. B. v. J. L. Hudson Company*, 135 F.2d 380, 384 (C. A. 6), certiorari denied, 320 U. S. 740) and as the basis for enforcement of Board orders without review of the matters stipulated. *Pittsburgh Plate Glass Co. v. N. L. R. B.*, 313 U. S. 146, 159; *N. L. R. B. v. Henry Levaux, Inc.*, 115 F. 2d 105, 106 (C. A. 1), certiorari denied, 312 U. S. 682; *N. L. R. B. v. Gerling Furniture Co.*, 103 F. 2d 663 (C. A. 7); *N. L. R. B. v. Pure Oil Co.*, 103 F. 2d 497 (C. A. 5); *N. L. R. B. v. Fickett Brown Mfg. Co.*, 140 F. 2d 883, 885 (C. A. 5).

The rule that issues as to which a respondent has failed to file exceptions may not thereafter be litigated

before a court is a corollary of the well-settled doctrine that a party proceeded against by an administrative agency must exhaust his administrative remedies before resorting to the courts. See *Yakus v. United States*, 321 U. S. 414, 446; *Falbo v. United States*, 320 U. S. 549, 553; *United States v. Ruzicka*, 329 U. S. 287, 292. The interrelationship of these doctrines is demonstrated in the legislative history of the Administrative Procedure Act. In enacting that statute, Congress expressly recognized that under the rule requiring exhaustion of administrative remedies, a party might not secure judicial relief if he failed to appeal from the trial examiner to the administrative agency. As the House Committee on the Judiciary said in explaining Section 10 of the Administrative Procedure Act (H. Rept. No. 1980, 79th Cong., 2d Sess., p. 55) :

It should be noted that Section 8 (a) permits agencies to provide by rule for appeals to them from initial decisions of examiners. That provision, as well as this provision of Section 10 (c), would authorize an agency to adopt rules requiring a party to take a timely appeal to the agency before resorting to the courts. *A party can not wilfully fail to exhaust his administrative remedies and then after the agency action has become operative, either secure a suspension of the agency action by a belated appeal to the agency, or resort to court without having given the agency an opportunity to determine the question raised.* If he so fails he is precluded from judicial review by the application of the time-honored

doctrine of exhaustion of administrative remedies. [Emphasis supplied.]^s

3. *The statutory provisions and applicable decisions.*—For these reasons, when Congress amended the National Labor Relations Act, it implemented the provision of Section 10 (e) that “no objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances,” with an additional provision in Section 10 (c) that unless a party adversely affected by an intermediate report files exceptions thereto within twenty days, the “recommended order shall become the order of the Board.” Referring to this provision, the Court of Appeals for the Third Circuit in *N. L. R. B. v. Stocker Mfg. Co.*, 185 F. 2d 451, said at page 454:

On its face, the statutory provision for an intermediate report appears to be designed primarily to avoid the necessity of independent examination of the record by the Board unless the party adversely affected by the examiner’s recommendations shall file objection thereto.

In short Congress intended that the failure to file exceptions to the intermediate report be treated as

^s The Board’s rule (Sec. 102.46, N. L. R. B. Rules and Regulations, Series 6, amended March 1, 1951) providing that “no matter not included in a statement of exceptions [to a trial examiner’s report] may thereafter be urged before the Board or in any further proceedings,” is not, we submit, a “self-serving proviso” (*Red Spot* opinion, n. 3), but is simply an application of the doctrine of exhaustion of remedies, which Congress contemplated in the Administrative Procedure Act.

an expression of acquiescence in the correctness and propriety of the recommended order.

We submit that under these provisions a complete review of the record by this Court is neither required nor contemplated by the statute, beyond the determination that the Board has jurisdiction and has not plainly travelled outside the orbit of its authority. This is the result reached by the Supreme Court in *Marshall Field & Co. v. N. L. R. B.*, 318 U. S. 253, 255-256, and in *N. L. R. B. v. Cheney-California Lumber Co.*, 327 U. S. 385, 388. In both cases, the Court, relying specifically on Section 10 (e), held the Act precluded the courts from considering objections to a trial examiner's report when such objections had not been raised by specific exceptions filed with the Board. In the *Marshall Field* case, 318 U. S. at 255-256, the Court stated that a general exception to an intermediate report "did not apprise the Board that petitioner intended to press the question now presented" and that the "salutary policy adopted by Section 10 (e) of affording the Board opportunity to consider on the merits questions to be urged upon review of its order * * * makes * * * presentation [of such questions] to the Board a prerequisite to judicial review."

Again, in the *Cheney California* case, 327 U. S. at 388, the Court emphasized that Section 10 (e) explicitly limited the reviewing powers of the courts, stating:

A limitation which Congress has placed upon the power of courts to review orders of the Labor Board is decisive of this case. Section

10 (e) of the Act commands that “no objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the Court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances.” We have heretofore had occasion to respect this explicit direction of Congress. *Marshall Field and Company v. N. L. R. B.*, 318 U. S. 253; and see *May Department Stores Co. v. N. L. R. B.*, 326 U. S. 376, n. 5. By this provision, Congress has said in effect that in a proceeding for enforcement of the Board’s order *the court is to render judgment on consent as to all issues that were contestable before the Board but were in fact not contested*. Cf *Pope v. United States*, 323 U. S. 1. *Justification of such an order, which necessarily involves consideration of the facts which are the foundation of the orders, is not open for review by a court, if no prior objection has been urged before the case gets into court and there is a total want of extraordinary circumstances to excuse failure or neglect to urge such objection.* [Emphasis added.]⁹

The “explicit direction of Congress” has been followed by this Court and the Courts of Appeals of other Circuits. *N. L. R. B. v. Townsend*, *supra*; *N. L. R. B. v. Kinner Motors, Inc.*, 154 F. 2d 1007 (C. A. 9); *N. L. R. B. v. Van De Kamp’s Holland-*

⁹ The opinion in the *Red Spot* case, *supra*, infers in footnote 6 that the effect of the foregoing portion of the opinion in the *Cheney California* case has been changed by statute. As we show below (pp. 15–23), neither the Administrative Procedure Act, nor the Labor Management Relations Act, 1947, effected any change in this regard other than, as we think, to strengthen the inference of acquiescence flowing from failure to file exceptions.

Dutch Bakeries, Inc., 154 F. 2d 828 (C. A. 9); *N. L. R. B. v. Draper Corporation*, 159 F. 2d 294, 298 (C. A. 1); *N. L. R. B. v. Winter*, 154 F. 2d 719, 722, n. 7 (C. A. 10).

The *Marshall Field* and *Cheney* cases establish that where specific objection is not pressed before the Board, it may not thereafter be urged in court as grounds for setting aside or modifying the Board's order. Since the rule as stated by the Supreme Court is rooted in "the salutary policy * * * of affording the Board opportunity to consider on the merits questions to be urged upon review of its order," the result, we submit, must be the same where an objection, though raised, is later abandoned before the Board as where it was never raised before the Trial Examiner in the first place. And this result, already implicit in the general rule governing the failure to take exceptions, is now reinforced by the amendment to Section 10 (c) which specifically precludes the Board from examining into a record in the absence of exceptions and requires it to issue as its order the order recommended by the Trial Examiner.

The legislative history of the amendment of Section 10 (c) supports this position.¹⁰ The amendment was objected to by the opponents of the amendatory

¹⁰ Footnote 8 of the opinion in the *Red Spot* case states that in view of the passage of the Administrative Procedure Act, especially Section 10 (e), the legislative history of Section 10 (c) of the National Labor Relations Act, as amended, cannot be fitted into the construction urged by the Board. We discuss the impact of the Administrative Procedure Act below (pp. 19-22).

legislation, on the ground that (Report No. 245 on H. R. 3020, 80th Cong., 1st Sess., p. 93):

It in effect suspends the doctrine of exhaustion of administrative remedies and permits a dissatisfied litigant to sidestep the agency by direct resort to the courts. The agency may be first called upon to defend a decision it has not made, or be reversed as to the rulings which, if error therein had been called to its attention by appropriate appeal, it might have itself corrected. Moreover, the status of trial examiners' reports is already covered by the Administrative Procedure Act of 1946 [Section 8 and 10 (c)] and there is no need at this time for further legislation on the subject.

Senator Taft answered this contention in an analysis which he inserted in the Congressional Record as follows (93 Cong. Rec. 6860):

Section 10 (c): In an effort to lessen the work load of the Board and facilitate its disposition of cases this subsection was amended to give finality to recommended orders of trial examiners without Board review if no exceptions were taken within 20 days. It has been stated that this permits an unsuccessful litigant to stand idly by while an erroneous report of a trial examiner becomes the order of the Board and then embarrass the Board when the case goes into the courts for enforcement. Several checks would prevent this happening. Section 10 (e) provides, "No objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the

court.”¹¹ In addition, the attorney trying the case would presumably file exceptions to such a report and the General Counsel in any event would not go forward with enforcement if the order was erroneous.

Senator Taft thus correlated the amendment with Section 10 (e) under which courts had refused to review any issue as to which an exception had not been filed by a respondent.

The 1947 amendments to the National Labor Relations Act are significant also in other respects. Thus, as we have seen, Congress amended Section 10 (c) to provide that if no exceptions are filed to the Intermediate Report, “such recommended order shall become the order of the Board and become effective as therein prescribed.” Unless the phrase “and become effective” is pure surplusage, it would seem that Congress contemplated a judicial decree would follow upon a Board order which was entered in accordance with the requirements of Section 10 (c). Congress was well aware that Board orders are not self-enforcing, but required judicial approval before they become “effective.” Consequently in providing in Section 10 (c) that a trial examiner’s order shall not only “become the order of the Board” but shall “become effective as therein prescribed,” Congress apparently anticipated that a judicial sanction would follow upon the issuance of such an order of the Board.

¹¹ The reference to Section 10 (c) is obviously a typographical error in the Congressional Record. The proviso referred to appears in Section 10 (e).

In addition, Congress reenacted Section 10 (e) without change, thereby indicating approval of the principle of preclusion of judicial review as enunciated in the *Cheney California, Marshall Field*, and other cases above cited (*supra*, pp. 13-15). See *N. L. R. B. v. Gullett Gin Co.*, 340 U. S. 361, 365-366; *Johnson v. Manhattan Ry. Co.*, 289 U. S. 479, 500; *Heald v. District of Columbia*, 254 U. S. 20, 23. Indeed, with due deference to the suggestion in the *Red Spot* opinion that the amendments to the Act broadened the area of judicial review, we respectfully submit that since Congress reenacted Section 10 (e), continuing the previous restraint on review by the courts, and amended Section 10 (c) to impose new limitations on review by the Board, the amended Act restricted the *areas* of review, at the same time that, as shown below, it expanded the *scope* of review within the area as thus restricted. Certainly Congress in depriving the Board of reviewing power over this class of case did not intend to burden the courts with the initial review of a record which Congress closed to review by the Board.

Significant, also, is the recent action of the Supreme Court in *N. L. R. B. v. Mexia Textile Mills*, 339 U. S. 563, and in *N. L. R. B. v. Pool Mfg. Co.*, 339 U. S. 577. In these cases the Board had adopted the recommended orders of Trial Examiners when the respondents failed to file exceptions thereto, and moved the Court of Appeals for the Fifth Circuit for summary entry of decrees. Upon motions of the respective respondents, the Court remanded the cases to the Board to take additional evidence as to whether and

to what extent its orders had been complied with and whether the cases were moot. 24 L. R. R. M. 2147; 25 L. R. R. M. 2295. The Supreme Court vacated the orders of the Court of Appeals and remanded the cases with direction that “enforcement of the Board’s order [be] decreed pursuant to Section 10 (e), unless ‘extraordinary circumstances’ are pleaded which justify the respondent’s failure to urge its objections before the Board” (339 U. S. at pp. 570, 582). It is to be noted that the Supreme Court interpreted the failure to file exceptions as a “failure to urge * * * objections before the Board,” even though, as in the *Pool* case, the respondent had contested the case before the trial examiner. Thus, the Supreme Court observed in its opinion (336 U. S. at p. 579, n. 2) that the trial examiner had rejected respondent’s allegation that the union no longer represented the majority in the bargaining unit—a contention which it reasserted in the Court of Appeals. Compare footnote 3 of the *Red Spot* opinion.

4. *The Administrative Procedure Act.*—The Court in the *Red Spot* opinion suggested (n. 8) that “in view of the * * * declared intent in [the Administrative Procedure Act] to give final powers of interpretation to the courts,” the Board’s contention must be rejected. But the Administrative Procedure Act does not grant judicial review over agency action in areas where such review is denied or limited by the National Labor Relations Act. Congress in the Administrative Procedure Act expressly made the judicial review provisions of Section 10 (5 U. S. C. 1009 (e)) subject to statutes which limit the right and scope of review

in specific instances. Thus the provisions of Section 10 are prefaced by the following limitation:

Except so far as (1) statutes preclude judicial review or (2) agency action is by law committed to agency discretion

Emphasizing the foregoing "excepting" clause, this Court in *Willapoint Oysters v. Ewing*, 174 F. 2d 676, certiorari denied, 338 U. S. 860, held that "the review provisions [of the Administrative Procedure Act and of the substantive statute involved] are in pari materia; both relate to the same matter or subject, and it is our view that they dovetail and should be considered together and given effect" (174 F. 2d at page 686). The authorities are in universal accord: *Ludecke v. Watkins*, 335 U. S. 160, 163; *Kirkland v. Atlantic Coast Line Railroad Company*, 167 F. 2d 529 (C. A. D. C.), certiorari denied, 335 U. S. 843; *Ohio Power Company v. N. L. R. B.*, 164 F. 2d 275 (C. A. 6); *Olin Industries v. N. L. R. B.*, 72 F. supp. 225, 228 (D. Mass.); *Brisbois v. Hague*, 85 F. Supp. 13, 14 (D. Mass.); *McEachern v. United States*, 84 F. Supp. 902, 904-905 (W. D. S. Car.); *The Great Lakes Steel Corporation v. United States*, 81 F. Supp. 450, 455 (E. D. Mich.); Davis, *Scope of Review of Federal Administrative Action*, 50 Columbia L. R. 559, 561 (1950).

As stated in the Attorney General's Manual on the Administrative Procedure Act (Federal Prison Industries, Inc., Press, 1947, pp. 94-95):

Section 10 applies "Except so far as (1) statutes preclude judicial review or (2) agency action is by law committed to agency discre-

tion.” The intended result of the introductory clause of section 10 is to restate the existing law as to the area of reviewable agency action. House Hearings (1945) p. 38 (Sen. Doc. p. 84).

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In addition, the introductory clause of section 10 provides a most important principle of construction for reconciling the provisions of the section with other statutory provisions relating to judicial review. All of the provisions of section 10 are qualified by the introductory clause, “*except so far as* (1) statutes preclude judicial review or (2) agency action is by law committed to agency discretion.” [Emphasis supplied.] The emphasized phrase does not mean that every provision of section 10 is applicable except *where* statutes preclude judicial review altogether. Instead, it reads “*Except so far as* (1) statutes preclude judicial review,” with the clear result that some other statute, while not precluding review altogether, will have the effect of preventing the application of some of the provisions of section 10. The net effect, clearly intended by the Congress, is to provide for a dovetailing of the general provisions of the Administrative Procedure Act with the particular statutory provisions which the Congress has moulded for special situations.¹²

In applying Section 10 of the Administrative Procedure Act, the Court of Appeals for the District of Columbia in *Kirkland v. Atlantic Coast Line Railroad Company*, *supra*, held that where a statute, such as the

¹² The foregoing interpretation of Section 10 by the Attorney General was cited with approval by this Court in *Willapoint Oysters v. Ewing*, *supra*, at p. 686.

Railway Labor Act, as construed by the Supreme Court in *Switchmen's Union v. National Mediation Board*, 320 U. S. 297, 305, did not provide judicial review of agency action, Section 10 of the Administrative Procedure Act "leaves the situation unchanged" (167 F. 2d at pages 529-530). The legislative history of that Act, the Court held, indicates "that when statutes 'withhold' judicial review they 'preclude' it" (*ibid*). Since, as the Supreme Court held in the *Marshall Field* and *Cheney* cases, Section 10 (e) of the National Labor Relations Act precludes judicial review in the absence of exceptions filed with the Board, it follows that the Administrative Procedure Act, which did not create any new area of judicial review, has not altered the former rule.

5. *The impact of the Pittsburgh Steamship and Universal Camera decisions.*—The opinion in the *Red Spot* case adverts to the recent decisions in *Universal Camera Corp. v. N. L. R. B.*, 340 U. S. 474, and *N. L. R. B. v. Pittsburgh Steamship Co.*, 340 U. S. 498. The Board respectfully submits, however, that as pointed out by Circuit Judge Pope in his concurring opinion, these cases do not modify the rule in *Cheney California*, which is applicable here. In *Universal Camera* and in *Pittsburgh Steamship*, the Court was dealing with cases in which exceptions had been filed, and the issue before the Court was the proper interpretation of the substantial evidence rule as affecting the scope of judicial review of questions of fact in cases properly before the Court. The limiting provision of Section 10 (e) was neither involved nor referred to by the Court, nor did the Court allude to

the *Cheney California* decision or to its more recent decisions in *Pool* and *Mexia, supra*. In these circumstances we believe the *Universal* and *Pittsburgh* cases stand only for the proposition that where exceptions have been filed and the Court has reviewing powers, it should exercise a greater scope of review, and not as granting power to review agency action as to which power to review does not exist.

* * * * *

For the foregoing reasons the Board respectfully requests that this Court reconsider the views expressed in the majority opinion in the *Red Spot* case, and enter a decree enforcing the order of the Board without reviewing the entire record.

II

In any event, the Board's findings that respondents engaged in unfair labor practices in violation of Section 8 (a) (1) and (3) of the Act are fully supported by the evidence

Assuming that this Court feels constrained to review the record before enforcing the order of the Board, the Board submits that such an examination will disclose that the Board's findings are amply supported by substantial evidence. Indeed the fact that respondents, although represented at all stages by counsel, found no occasion to except to any of the findings or conclusions, in itself suggests that the Trial Examiner's report is supported by the record. Furthermore, the fact that the Trial Examiner dismissed the complaint as to seven of the fifteen alleged discriminatees bespeaks his careful appraisal of the evidence before him. To assist the Court in such

review as it deems necessary, the Board presents the following statement of the Trial Examiner's findings together with a brief statement of the supporting evidence.¹³

A. The business of the respondents

The respondents, George Noroian and Archie Noroian, are brother and sister and, as copartners under the name of George Noroian Company, own and operate a fruit processing, packing, and canning plant in or near Dinuba, California (I. R. 3; T. 6-7). The establishment is located on a 65-acre farm which the respondents also own. The operations conducted in the plant consist, in the main, of the canning and packing of peaches, apricots, plums, nectarines, grapes, and figs, and the manufacture of candied fruits (I. R. 3; T. 7). Approximately 30 percent of the fruit packed or processed in the plant is grown on the respondents' farm; the balance of the plant's output is purchased from other growers (I. R. 3; T. 305-306). All of the employees concerned in the present proceeding were employed in the plant during the period in question and were engaged in occupations relating to the packing, canning, or other processing of fruits (I. R. 3; T. 254, 305, respondents' exhibit no. R. 5). The Trial Examiner found that

¹³ In the ensuing statement, references to the findings in the Intermediate Report of the Trial Examiner are designated as I. R. —; references to supporting evidence in the stenographic transcript of the record are designated as T.—.

such employees were not employed as agricultural laborers within the meaning of the Act (I. R. 3).¹⁴

In the regular course and conduct of their business, respondents annually produce canned and candied fruits at a value in excess of \$150,000 per year. Between 40 and 50 percent of such products are sold to customers located in States other than California and are shipped in interstate commerce by respondents to points outside California (I. R. 3; T. 14). The Trial Examiner found that at all times material to the issues in this proceeding respondents were engaged in interstate commerce within the meaning of the Act (I. R. 3).

B. The unfair labor practices

1. Prefatory statement

On August 14, 1949, Cannery Food Processors, Cotton Warehousemen and Helpers, Local Union No. 97, herein referred to as the Union, began to solicit signatures among the employees to a document purporting to petition the Board for "a certified election." Boyce Partain, an employee, circulated the petition near the plant as employees entered or left the establishment. Partain, after securing a substan-

¹⁴ Although respondents in their answer had alleged that the employees were agricultural laborers, they appear to have abandoned this position inasmuch as they did not urge it as a ground for dismissal nor did they advert to it in their brief filed with the Trial Examiner. In any event, each of the employees involved testified without contradiction that they were employed in the canning and processing plant and the Trial Examiner found that the allegation that the employees were agricultural workers was without merit (I. R. 3).

tial number of signatures, turned the document over to William Fowler, the Union's business agent, on August 20 (I. R. 5; T. 16). All seven employees who were discriminatorily discharged¹⁵ had signed the petition.

2. Employees Elsie Hunt and Virginia Dodson

Employees Hunt and Dodson were employed on the day shift (I. R. 7; T. 57), and were discharged on August 19, about an hour before the day shift ended (I. R. 8; T. 57-58), after they had been interrogated by a floor lady and by Archie Noroian as to whether they were connected with the Union and had signed "the union paper" (I. R. 7, 8; T. 54, 59). While they were in the office waiting for their checks, Archie Noroian expressed the view, in substance, that neither the plant nor the employees were suitable subjects for unionization and concluded with the statement that Hunt and Dodson, as well as the others who had signed the petition, would be blacklisted for employment with other packing plants in the area (I. R. 8; T. 59).¹⁶

¹⁵ These were employees Hunt and Dodson (I. R. 7; T. 52, 60); Moser and Davis (I. R. 12; T. 122-123, General Counsel's Exhibit No. 3); Stegall (I. R. 14; T. 137); Suggs (I. R. 18; T. 165-166); Holmes (I. R. 21; T. 147-148).

¹⁶ Archie Noroian denied only that she had ever made inquiry of any of the plant's employees concerning their union activities or that she threatened to have those who signed the petition blacklisted (I. R. 8; T. 339-342). She also testified that she did not learn of the existence of the representation petition until the morning of August 20 (I. R. 8; T. 347). The trial examiner found that, except when Hunt was hired and discharged, she had no other contact with Archie Noroian. Yet some of the remarks she attributed to Archie concerning the adaptability of the plant and its employees to unionization were significantly reminiscent of similar statements made by George Noroian on the witness

The trial examiner rejected respondents' defense that employees Hunt and Dodson were laid off as part of a general layoff at the close of the peach season and that efficiency factors were used to determine which employees should be laid off.¹⁷ He pointed out that respondents offered no evidence bearing upon the quantity or quality of Hunt's and Dodson's production, and that the employees who were laid off were permitted to complete their shift, while Hunt and Dodson were discharged before the end of the shift and were paid off immediately (I. R. 9; T. 270, 59).

The trial examiner concluded that the interrogation of Hunt and Dodson and the threat to blacklist them violated Section 8 (a) (1) of the Act and that the discharge of Hunt and Dodson contravened both that section and Section 8 (a) (3) (I. R. 10).

stand after Hunt had testified (I. R. 10; Cf. T. 57 and T. 287-288, 298). This, the trial examiner observed, lent a note of authenticity to Hunt's version of her conversation with Archie Noroian when she was discharged (I. R. 10).

¹⁷ Respondents' plant operations are seasonal in character and are controlled, in a substantial degree, by the harvest periods for the respective types of fruit and the flow of the products to and through the plant. The unfair labor practices occurred during the week of August 19, 1949, during the climax of the peach-canning season. During that week, the plant operated on a day and night shift basis. As respondents were uncertain of the exact period and scope of the nectarine harvest which was immediately anticipated, they laid off the night shift employees, but instructed them to keep in touch with the plant in order to be advised when a night shift would be necessary (I. R. 4-5; T. 270-271). None of the 7 employees here in question were involved in the layoff.

3. Employees Robert Ray Moser and W. O. Davis

Employees Moser and Davis were employed on the day shift in labeling cans (I. R. 11-12; T. 121), and were abruptly discharged on Saturday, August 20, before the end of the day shift (I. R. 12; T. 124-125), after Ouzounian, their supervisor,¹⁸ had interrogated them concerning the signing of the petition and had learned that they had signed (I. R. 12; T. 124-125). Since it is undisputed that Moser and Davis worked on August 20, the Trial Examiner held that the termination of their employment could not be considered as part of the general lay-off that occurred on August 19 (I. R. 13). Ouzounian gave no testimony as to any circumstances surrounding the termination of Moser's and Davis' employment, and the Trial Examiner did not credit his bare denial of the interrogation (I. R. 12).

The Trial Examiner therefore found that Ouzounian's interrogation of employees Moser and Davis concerning their signing the petition violated Section 8 (a) (1), and that Ouzounian, in violation of Section 8 (a) (1) and (3), discharged both employees because they had signed that document (I. R. 13).

¹⁸ Ouzounian (also referred to in the record as Chuck) was the supervisor in charge of the plant's receiving department (I. R. 4). Among other duties, he supervised the employees who received the raw fruit as it arrived at the plant and thereafter distributed the product throughout the plant (I. R. 4; T. 308). He had, on several occasions, hired employees but had not discharged any (I. R. 4; T. 309).

4. Employee Lee Stegall

Lee Stegall was employed on the day shift in stacking and trucking cans (I. R. 14; T. 136, 146). After working all day on Saturday, August 20, he was instructed by Ouzounian to work that night (I. R. 14; T. 145). That evening, before he returned to work on the night shift, and while he was standing with several other persons at a soft-drink machine in the plant, George Noroian approached the group and, referring to the employees who had been laid off and were marching up and down the road in front of the plant, told the people at the machine "Not to pay any attention to that union bunch out there, if we wanted to keep our jobs" (I. R. 15; T. 138). Noroian also said that other canneries had had to close because they could not pay the wages desired by the union (*ibid.*)¹⁹ About 15 minutes later, as Stegall was returning to work, he encountered Archie Noroian who admittedly discharged him (I. R. 16; T. 139, 340). When Ouzounian learned from Stegall that the latter had been discharged, he asked him the

¹⁹ Noroian's denial of the foregoing statement was not credited by the trial examiner who stated that Noroian did not impress him as a factual and objective witness (I. R. 15). The trial examiner pointed out that at various points Noroian gave exaggerated emphasis to incidents, some wholly ungermane (see, e. g. T. 296-297, 256-261) and colored his evidence with statements and conclusions which were not compatible with the facts (I. R. 15). Thus, for example, in an effort to underline the contention that the plant employees constituted "agricultural labor," he stated that the plant "primarily" processes and packs fruits "that we grow ourselves" (I. R. 15; T. 246). Later, when asked to give specific figures, he testified that approximately 70 percent of the plant's output is grown on farms belonging to others (I. R. 15; T. 305-306).

reason for the dismissal. Stegall replied, "Well, I guess like the rest of them, because of signing that paper" (I. R. 16; T. 140). Ouzounian responded, "You guys ought to know better than that" (*ibid.*).

Archie Noroian testified that she discharged Stegall because he had "Started working when he wasn't supposed to be working" and that she told him "You were not supposed to go back to work until you were told to go to work" (I. R. 16; T. 340). The trial examiner rejected this explanation, observing that Ouzounian did not deny that Stegall had worked all day on Saturday and that he had requested Stegall to continue working on Saturday night (I. R. 17). The trial examiner concluded that "It seems incredible that Ouzounian would permit Stegall to work contrary to a policy established by the Noroians" (I. R. 18).

The trial examiner concluded that George Noroian's and Ouzounian's remarks constituted restraint and coercion in violation of Section 8 (a) (1) of the Act and that Stegall's discharge violated Section 8 (a) (3) and (8) (a) (1) of the Act (I. R. 15, 18).

5. *Employee Suggs*

Walter A. Suggs was also employed on the day shift, doing janitorial work (I. R. 18; T. 163-164, 174). At the end of the day on Friday, August 19, Ouzounian told him to return to work on Monday (I. R. 18; T. 168). He returned to the plant on Saturday with his wife to get her last pay check. She had previously been employed in the plant and

had been laid off on Friday (I. R. 18; T. 169, 177, 179). There he encountered Archie Noroian who told him to get his check for his earnings for the last week of work²⁰ (I. R. 18; T. 167–170). Because the bookkeeper had some difficulty in computing the pay, Suggs called Ouzounian to the office to guide the bookkeeper in making the computation. In so doing he told Ouzounian that he would not return on Monday. Ouzounian replied, “Well, you boys have made it hard on yourselves.” (I. R. 18; T. 17.)²¹

The trial examiner pointed out that while George Noroian testified to instructions for a general layoff at the close of the night shift on August 19, there was no evidence that Suggs was laid off on that day and it was peculiar that Archie Noroian, and not Ouzounian, who was Suggs’ supervisor, notified Suggs of his discharge. The latter circumstance is incompatible with George Noroian’s testimony that he had supervision over the male supervisors and male employees and that his sister, Archie, had supervision over the females (I. R. 17; T. 272–273).

The trial examiner concluded that in view of Ouzounian’s position, his remark that “You boys made it hard on yourselves” had the plain implica-

²⁰ The plant’s regular payday is on Friday of each week. The respondents follow the practice of withholding an employee’s pay for one week and of paying him in the week following the one in which the work was performed (I. R. 5; T. 167–168).

²¹ For reasons fully spelled out in the intermediate report (I. R. 11, 12, 13, 17, 19), the trial examiner did not credit Ouzounian’s denial of Suggs’ testimony, nor did he credit George Noroian’s testimony that Suggs was incompetent and that he had instructed Archie Noroian to discharge him (I. R. 19).

tion that discharge was the penalty for concerted activity, and such statement therefore contravened Section 8 (a) (1) of the Act. The trial examiner also found that Suggs was discharged because respondents believed he had engaged in union activity, and that the dismissal violated Section 8 (a) (1) and 8 (a) (3) of the Act.

6. Employee Ellen Holmes

Ellen Holmes was also employed on the day shift (I. R. 21; T. 148). At the end of her shift on August 19, Holmes was among a group of employees standing outside the plant office waiting for their pay. Archie Noroian came up to the group and stated that "Everyone who was for the union or wanted union" was "to get out" and that such persons were "fired" (I. R. 21; T. 149). Holmes interpreted Archie Noroian's statement that she was being discharged. When she got her check, she left (I. R. 21; T. 150).²² From his observation of Holmes' demeanor and from the quality of her testimony, the trial examiner credited her testimony and found that although Archie Noroian's statements were not directed specifically at Holmes, the latter was warranted in construing the remarks as applicable to her and as affecting her discharge (I. R. 22). He concluded that Archie Noroian's remarks were in violation of

²² Archie Noroian testified that she did not remember Employee Holmes and denied making the statement attributed to her. For reasons fully discussed in the Intermediate Report, the trial examiner did not credit Archie Noroian's denial (I. R. 22).

Section 8 (a) (1) and that Holmes' discharge was in violation of Section 8 (a) (1) and (3) of the Act.

We submit that the foregoing statement demonstrates that the trial examiner's findings are amply supported by substantial evidence. The Board's order ²³ should therefore be enforced.

Respectfully submitted.

GEORGE J. BOTT,
General Counsel,

DAVID P. FINDLING,
Associate General Counsel,

A. NORMAN SOMERS,
Assistant General Counsel,

FREDERICK U. REEL,

ABRAHAM H. MALLER,
Attorneys,

National Labor Relations Board.

NOVEMBER 1951.

²³ The Board's order requires the respondents to cease and desist from the unfair labor practices found and directs them to offer the discharged employees reinstatement and to make them whole for any loss of pay they may have suffered by reason of respondents' discrimination against them. In this regard, the Board's order takes account of the fact that respondents' operations are of a seasonal character and depend substantially upon the respective periods of harvest of the types of fruits processed in the plant. The Board's order also requires respondents to post notices.

APPENDIX

1. The relevant provisions of the National Labor Relations Act (Act of July 5, 1935, 49 Stat. 449, 29 U. S. C. 151, *et seq.*) are as follows:

* * * * *

PREVENTION OF UNFAIR LABOR PRACTICES

SEC. 10. (a) The Board is empowered, as hereinafter provided, to prevent any person from engaging in any unfair labor practice (listed in section 8) affecting commerce. * * *

(c) * * * If upon all the testimony taken the Board shall be of the opinion that any person named in the complaint has engaged in or is engaging in any such unfair labor practice, then the Board shall state its findings of fact and shall issue and cause to be served on such person an order requiring such person to cease and desist from such unfair labor practice, and to take such affirmative action, including reinstatement of employees with or without back pay, as will effectuate the policies of this Act. * * *

* * * * *

(e) The Board shall have power to petition any circuit court of appeals of the United States * * * wherein the unfair labor practice in question occurred or wherein such person resides or transacts business, for the enforcement of such order and for appropriate temporary relief or restraining order, and shall certify and file in the court a transcript of the entire record in the proceeding, including the pleadings and testimony upon which such order was entered and the findings and order of the Board. Upon such filing, the court shall cause

notice thereof to be served upon such person, and thereupon shall have jurisdiction of the proceeding and of the question determined therein, and shall have power to grant such temporary relief or restraining order as it deems just and proper, and to make and enter upon the pleadings, testimony, and proceedings set forth in such transcript a decree enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part the order of the Board. No objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances. The findings of the Board as to the facts, if supported by evidence, shall be conclusive. * * * The jurisdiction of the court shall be exclusive and its judgment and decree shall be final, except that the same shall be subject to review * * * by the Supreme Court of the United States upon writ of certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 346 and 347).

2. The relevant provisions of the Labor Management Relations Act of 1947 (61 Stat. 136, 29 U. S. C. Supp. I, 141 *et seq.*) are as follows:

* * * *

SEC. 101. The National Labor Relations Act is hereby amended to read as follows:

* * * *

“SEC. 8. (a) It shall be an unfair labor practice for an employer—

“(1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7;

* * * *

“(3) by discrimination in regard to hire or tenure of employment or any term or con-

dition of employment to encourage or discourage membership in any labor organization: * * *

* * * * *

“SEC. 10. * * *

* * * * *

“(c) The testimony taken by such member, agent, or agency or the Board shall be reduced to writing and filed with the Board. Thereafter, in its discretion, the Board upon notice may take further testimony or hear argument. If upon the preponderance of the testimony taken the Board shall be of the opinion that any person named in the complaint has engaged in or is engaging in any such unfair labor practice, then the Board shall state its findings of fact and shall issue and cause to be served on such person an order requiring such person to cease and desist from such unfair labor practice, and to take such affirmative action including reinstatement of employees with or without back pay, as will effectuate the policies of this Act: * * *. In case the evidence is presented before a member of the Board, or before an examiner or examiners thereof, such member, or such examiner or examiners, as the case may be, shall issue and cause to be served on the parties to the proceeding a proposed report, together with a recommended order, which shall be filed with the Board, and if no exceptions are filed within twenty days after service thereof upon such parties, or within such further period as the Board may authorize, such recommended order shall become the order of the Board and become effective as therein prescribed.

* * * * *

“(e) The Board shall have power to petition any circuit court of appeals of the United States * * * wherein the unfair labor practice in question occurred or wherein such person

resides or transacts business, for the enforcement of such order and for appropriate temporary relief or restraining order, and shall certify and file in the court a transcript of the entire record in the proceedings, including the pleadings and testimony upon which such order was entered and the findings and order of the Board. Upon such filing, the court shall cause notice thereof to be served upon such person, and thereupon shall have jurisdiction of the proceeding and of the question determined therein, and shall have power to grant such temporary relief or restraining order as it deems just and proper, and to make and enter upon the pleadings, testimony, and proceedings set forth in such transcript a decree enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part the order of the Board. No objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances. The findings of the Board with respect to questions of fact if supported by substantial evidence on the record considered as a whole shall be conclusive.”

* * * * *

3. The relevant provisions of the Administrative Procedure Act (60 Stat. 237, 5 U. S. C. 1001, *et seq.*) are as follows:

* * * * *

SEC. 7 * * *

(c) *Evidence*.—Except as statutes otherwise provide, the proponent of a rule or order shall have the burden of proof. Any oral or documentary evidence may be received, but every agency shall as a matter of policy provide for the exclusion of irrelevant, immaterial, or unduly repetitious evidence and no sanction shall be imposed or rule or order be issued except

upon consideration of the whole record or such portions thereof as may be cited by any party and as supported by and in accordance with the reliable, probative, and substantial evidence. * * *

* * * * *

SEC. 10. Judicial review of agency action except so far as (1) statutes preclude judicial review or (2) agency action is by law committed to agency discretion.

* * * * *

(e) *Scope of review.*—So far as necessary to decision and where presented the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of any agency action. It shall (A) compel agency action unlawfully withheld or unreasonably delayed; and (B) hold unlawful and set aside agency action, findings, and conclusions found to be (1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (2) contrary to constitutional right, power, privilege, or immunity; (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (4) without observance of procedure required by law; (5) unsupported by substantial evidence in any case subject to the requirements of sections 7 and 8 or otherwise reviewed on the record of an agency hearing provided by statute; or (6) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court. In making the foregoing determinations the court shall review the whole record or such portions thereof as may be cited by any party, and due account shall be taken of the rule of prejudicial error.

* * * * *

ORIGINAL

No. 13147

United States
Court of Appeals
for the Ninth Circuit.

ESTATE OF MABEL COCHRAN, Deceased;
SIDNEY ELMER COCHRAN and DON-
ALD ROBERT COCHRAN, Executors, and
JOSEPH E. COCHRAN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

Petition to Review a Decision of the Tax Court
of the United States

FILED

MAR - 3 1952



**United States
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ESTATE OF MABEL COCHRAN, Deceased;
SIDNEY ELMER COCHRAN and DON-
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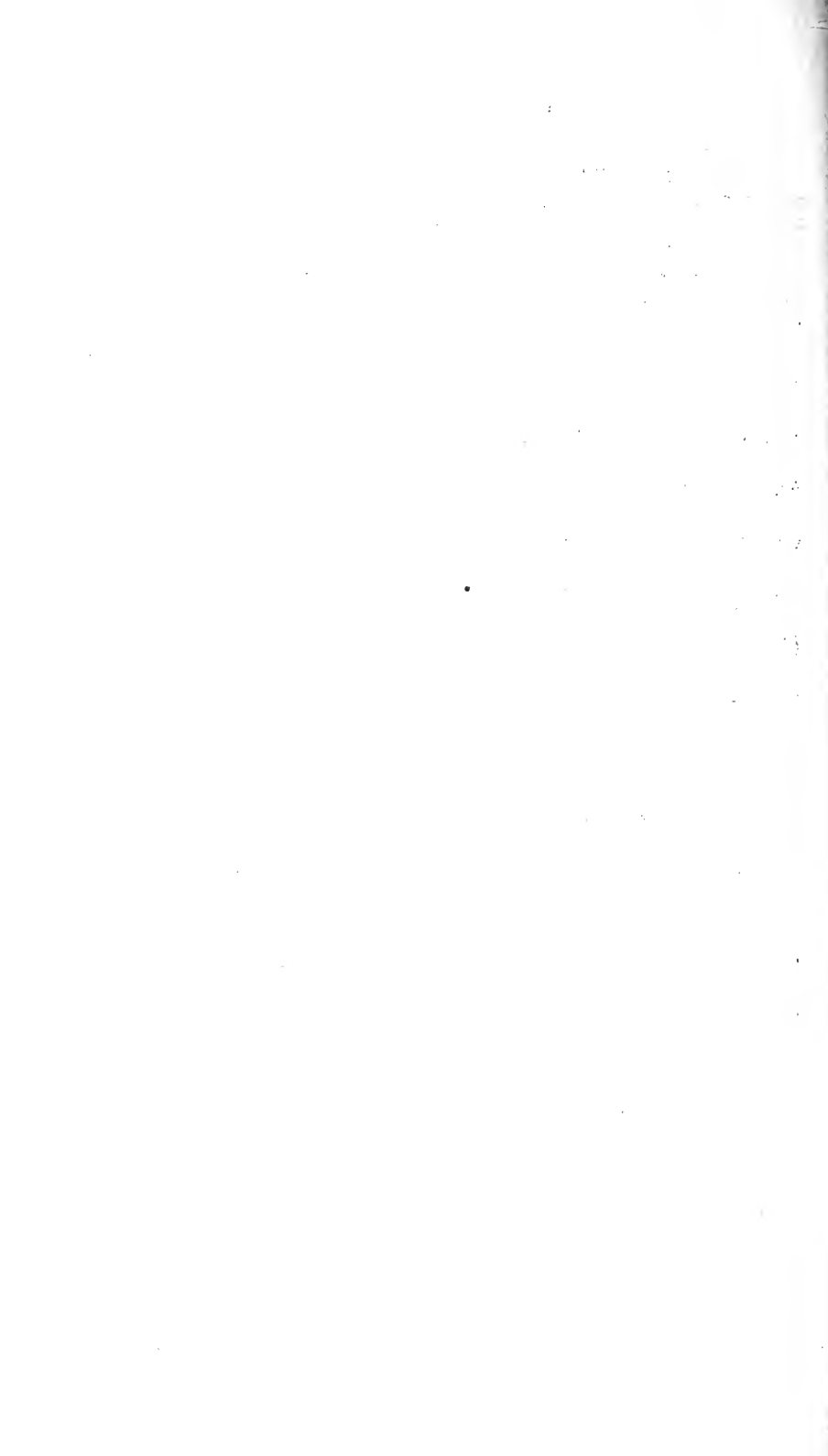
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

For Petitioner:

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EMMETT GEBAUER, ESQ.

For Respondent:

C. W. NYQUIST, ESQ.



The Tax Court of the United States

Docket No. 26266

ESTATE OF MABEL COCHRAN, Deceased;
SIDNEY ELMER COCHRAN and DONALD
ROBERT COCHRAN, Executors,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1949

Dec. 27—Petition received and filed. Taxpayer notified. Fee paid.

Dec. 27—Request for hearing in San Francisco, Calif., filed by taxpayer. Granted 1/9/50.

Dec. 29—Copy of petition served on General Counsel.

1950

Feb. 8—Answer filed by Respondent.

Feb. 13—Copy of answer served on taxpayer, San Francisco, Calif.

Mar. 8—Hearing set May 8, 1950, San Francisco, Calif.

May 11—Hearing had before Judge Hill on merits, stipulation of facts filed at hearing. Simultaneous briefs July 10, 1950. Replies August 9, 1950.

June 2—Transcript of Hearing 5/11/50 filed.

1950

July 10—Motion for extension of time to July 24, 1950, to file brief filed by Respondent. Granted.

July 10—Brief filed by taxpayer. Copy served 7/25/50.

July 24—Brief filed by General Counsel.

Aug. 21—Motion for extension to September 1, 1950, to file reply brief filed by taxpayer. Granted 8/21/50.

Aug. 23—Reply brief filed by General Counsel.

Aug. 31—Reply brief filed by taxpayer. Copy served.

1951

July 12—Memorandum findings of fact and opinion rendered. Hill J. Decision will be entered for Respondent. Copy served 7/16/51.

July 16—Decision entered. Black J. Div. 15.

Oct. 8—Petition for review by United States Court of Appeals, Ninth Circuit, filed by taxpayer.

Oct. 8—Designation of contents of record on review filed by taxpayer.

Oct. 8—Affidavit of Service by Mail filed.

Oct. 8—Proof of service of petition for review and designation of record filed by General Counsel.

The Tax Court of the United States

Docket No. 26267

JOSEPH E. COCHRAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

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The Tax Court of the United States

Docket No. 26266

ESTATE OF MABEL COCHRAN, Deceased;
SIDNEY ELMER COCHRAN and DONALD
ROBERT COCHRAN, Executors,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols IRA:90-D:EMR (C:TS:PD SF:GBW)) dated October 17, 1949, and as a basis for this proceeding alleges as follows:

1. The petitioner, viz., Estate of Mabel Cochran, deceased, is acting by and through Sidney Elmer Cochran and Donald Robert Cochran, the duly appointed and acting Executors of said deceased by virtue of proceedings had in the Superior Court of the State of California, in and for the County of Alameda. The principal office of the Executors is c/o Cochran & Celli, 12th and Harrison Streets, Oakland, California. The returns for the periods here involved were filed with the Collector for the First District of California.

2. The notice of deficiency (a copy of which is

attached hereto and marked Exhibit "A") was mailed to the petitioner on October 17, 1949.

3. The taxes in controversy are income and victory taxes in the amount of \$9,468.67 for the calendar year 1943, and income taxes in the amount of \$8,005.14 for the calendar year 1944.

4. The determinations of tax set forth in said notice of deficiency are based upon the following error:

(1) In determining the taxable net income of Mabel Cochran (deceased) for the years 1942 and 1943 and the year 1944, the Commissioner erroneously attributed to Mabel Cochran 50% of the distributive shares of the partnership income of her two daughters, Winifred Cochran Irwin and Bernice C. Johnson, from the partnership of Cochran & Celli, reported by them in each of the aforesaid years in their income tax returns as their taxable income as partners in Cochran & Celli, entitled to share in the net profits of said partnership. The Commissioner contends that said Winifred Cochran Irwin and Bernice C. Johnson should not be recognized as true partners of Cochran & Celli and that all of the net profits or income from said partnership attributed to them were in fact realized equally by Mabel Cochran and Joseph E. Cochran, her husband, the father of said daughters.

5. The facts upon which petitioner relies as the basis of this proceeding are as follows:

(1) Prior to January 1, 1938, Cochran & Celli, a Chevrolet automobile dealership in Oakland, Cali-

fornia, was operated by J. E. Cochran and Bernardo Celli, Sr., as partners, and during the year 1937 said persons discussed and arranged between themselves and their wives and their adult children, the reorganization of said business into a partnership composed of all of said persons. There followed a formal written partnership agreement executed by all of said persons, a true copy of which, dated January 1, 1938, is attached hereto and marked Exhibit "B."

(2) Each and all of said persons entered into said partnership agreement (Exhibit "B") with the intention of really and truly conducting and operating said business of Cochran & Celli as a bona fide partnership.

(3) The initial capital of Cochran & Celli under said partnership agreement (Exhibit "B") consisted of separate contributions of vested community property belonging to J. E. Cochran and Mabel Cochran, his wife, and to Bernardo Celli, Sr., and Anna Celli, his wife, and of property belonging to their children, Bernardo Celli, Jr., Lloyd Celli, Bernice M. Cochran (Johnson), Winifred Cochran (Irwin), and Sidney Elmer Cochran, derived by them from their parents by irrevocable and unsailable gifts. Said families of Cochran and Celli were and are unrelated to each other.

(4) Thereafter and continuously, each and all of said persons represented and conducted themselves really and truly as partners of Cochran & Celli.

Wherefore, the petitioner prays that this Court

may hear the proceeding and determine that there are no deficiencies due from the petitioner for the years 1943 and 1944.

/s/ ELI FREED,

/s/ EMMETT GEBAUER,

Counsel for Petitioners.

Duly verified.

Received and filed T. C. U. S. December 27, 1949.

Served December 29, 1949.

[Title of Tax Court and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above petitioner, admits and denies as follows:

1 to 3, inclusive. Admits the allegations contained in paragraphs 1 to 3, inclusive, of the petition.

4 (1). Denies the allegations of error contained in subparagraph (1) of paragraph 4 of the petition.

5 (1). Admits that prior to January 1, 1938, Cochran & Celli, a Chevrolet automobile dealership in Oakland, California, was operated by J. E. Cochran and Bernardo Celli, Sr., as partners, but denies the remaining allegations contained in subparagraph (1) of paragraph 5 of the petition.

(2) to (4), inclusive. Denies the allegations contained in subparagraphs (2) to (4), inclusive, of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioners' appeal denied.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

T. M. MATHER,

CHARLES W. NYQUIST,
Special Attorneys, Bureau of
Internal Revenue.

Received and filed T.C.U.S. February 8, 1950.

[Title of Tax Court and Cause.]

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols IRA:90-D:EMR (C:TS:PD SF:GBW)) dated October 17, 1949,

and as a basis for his proceeding alleges as follows:

1. The petitioner is an individual residing at 108 Van Ripper Road, Orinda, California. The returns for the periods here involved were filed with the Collector for the First District of California.

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit "A") was mailed to the petitioner on October 17, 1949.

3. The taxes in controversy are income and victory taxes in the amount of \$10,078.72 for the calendar year 1943, and income taxes in the amount of \$8,619.36 for the calendar year 1944.

4. The determinations of tax set forth in said notice of deficiency are based upon the following error:

- (1) In determining the taxable net income of the petitioner for the years 1942 and 1943 and the year 1944, the Commissioner erroneously attributed to the petitioner 50% of the distributive shares of the partnership income of his two daughters, Winifred Cochran Irwin and Bernice C. Johnson, from the partnership of Cochran & Celli, reported by them in each of the aforesaid years in their income tax returns as their taxable income as partners in Cochran & Celli, entitled to share in the net profits of said partnership. The Commissioner contends that said daughters, Winifred Cochran Irwin and Bernice C. Johnson, should not be recognized as true partners of Cochran & Celli and that all of the net profits or income from such partnership attributed to them were in fact realized equally by

petitioner and Mabel Cochran, the wife of petitioner, who was then living and who is now deceased.

5. The facts upon which petitioner relies as the basis of this proceeding are as follows:

(1) Prior to January 1, 1938, Cochran & Celli, a Chevrolet automobile dealership in Oakland, California, was operated by J. E. Cochran and Bernardo Celli, Sr., as partners, and during the year 1937 said persons discussed and arranged between themselves and their wives and their adult children, the reorganization of said business into a partnership composed of all of said persons. There followed a formal written partnership agreement executed by all of said persons, a true copy of which, dated January 31, 1938, is attached hereto and marked Exhibit "B."

(2) Each and all of said persons entered into said partnership agreement (Exhibit "B") with the intention of really and truly conducting and operating said business of Cochran & Celli as a bona fide partnership.

(3) The initial capital of Cochran & Celli under said partnership agreement (Exhibit "B") consisted of separate contributions of vested community property belonging to J. E. Cochran and Mabel Cochran, his wife, and to Bernardo Celli, Sr., and Anna Celli, his wife, and of property belonging to their children, Bernardo Celli, Jr., Lloyd Celli, Bernice M. Cochran (Johnson), Winifred Cochran (Irwin), and Sidney Elmer Cochran, derived by them from their parents by irrevocable and unas-

sailable gifts. Said families of Cochran and Celli were and are unrelated to each other.

(4) Thereafter and continuously, each and all of said persons represented and conducted themselves really and truly as partners of Cochran & Celli.

Wherefore, the petitioner prays that this Court may hear the proceeding and determine that there are no deficiencies due from the petitioner for the years 1943 and 1944, and for such relief as may be appropriate.

/s/ ELI FREED,

/s/ EMMETT GEBAUER,

Counsel for Petitioner.

Duly verified.

Received and filed T.C.U.S. December 27, 1949.

Served December 29, 1949.

[Title of Tax Court and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above petitioner, admits and denies as follows:

1 to 3, inclusive. Admits the allegations contained in paragraphs 1 to 3, inclusive, of the petition.

4 (1). Denies the allegations of error contained

in subparagraph (1) of paragraph 4 of the petition.

5 (1). Admits that prior to January 1, 1938, Cochran & Celli, a Chevrolet automobile dealership in Oakland, California, was operated by J. E. Cochran and Bernardo Celli, Sr., as partners, but denies the remaining allegations contained in subparagraph (1) of paragraph 5 of the petition.

(2) to (4), inclusive. Denies the allegations contained in subparagraphs (2) to (4), inclusive, of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioners' appeal denied.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

T. M. MATHER,
CHARLES W. NYQUIST,
Special Attorneys, Bureau of
Internal Revenue.

Received and filed T.C.U.S. February 8, 1950.

MINUTES OF PROCEEDINGS

The Tax Court of the United States

Date: May 11, 1950.

Place: San Francisco, Calif.

Docket No. 26266, 26267.

Proceeding: Est. of Mabel Cochran, Dec'd, Sidney Elmer Cochran and Donald Robert Cochran, Executors: Joseph E. Cochran.

Assigned to: Judge Hill, Division No. 2.

Counsel for Petitioner: Eli Freed, Esq., Emmett Gebauer, Esq., 1069 Mills Bldg., San Francisco, Calif.

Counsel for Respondent: C. W. Nyquist, Esq.

Stenographic Reporter: Osterman.

Hearing: 10-12:30, 2-3:25 (hour commenced and closed). Sub.

Transcript Ordered (Yes or No): Yes.

On the merits: Yes. On motion of.....

Ordered:

Filed at hearing: Stipulation of Facts in #26266, 26267.

Petitioners' brief

Respondent's brief: Simultaneous, July 10, 1950;
Reply, August 9, 1950.

Witnesses for Petitioner:

J. E. COCHRAN,
SIDNEY E. COCHRAN,
BERNICE C. JOHNSON,
WINIFRED C. IRWIN,
BERNARDO CELLI, JR.

Exhibits

Petitioner's (Number and Describe)

23—Partnership return of income.

24—Partnership return of income.

25—Partnership return of income.

26—Certificate.

/s/ MAUDE R. CARPENTER,
Acting Deputy Clerk.

Form 431

Rev. Oct., 1942.

The Tax Court of the United States

No. 26266

ESTATE OF MABEL COCHRAN, Deceased;
SIDNEY ELMER COCHRAN and DONALD
ROBERT COCHRAN, Executors,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 26267

JOSEPH E. COCHRAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STIPULATION OF FACTS

It is mutually stipulated and agreed, by and between the parties hereto, by their respective counsel, that the following statements may be taken as true by the Court with the reservation that this stipulation shall be without prejudice to the right of either party to introduce further evidence not inconsistent with the facts herein stipulated.

1. For a number of years prior to December 31, 1937, J. E. Cochran and Bernardo Celli, Sr., owned and operated as copartners a Chevrolet automobile dealership in Oakland, California, under the firm name "Cochran & Celli."

2. On December 31, 1937, Mabel Cochran was the wife of J. E. Cochran and Anna Celli was the wife of Bernardo Celli, Sr. The partnership interests referred to in paragraph 1, *supra*, constituted community property of the partners and their wives under the laws of California. On said date J. E. Cochran and Mabel Cochran had four children, Bernice M. Cochran, Winifred Cochran and Sidney Elmer Cochran, all adults, and Donald Robert Cochran, who was seventeen years of age. Bernardo Celli, Sr., and Anna Celli had two children, Bernardo Celli, Jr., and Lloyd Celli, both of whom were adults.

3. On December 31, 1937, the opening credit balances of J. E. Cochran and Bernardo Celli, Sr., on the books of the partnership were \$242,914.94 and \$237,605.44, respectively. As of said date journal entries were made transferring \$100,617.43 from the J. E. Cochran investment account to a new account set up in the name of Mabel Cochran and transferring \$102,024.88 from the Bernardo Celli, Sr., investment account to a new account set up in the name of Anna Celli. As of said date other entries were made transferring amounts from the accounts of each of the four parents to each of their respective adult children. Attached hereto and marked Exhibits 1 through 6 are excerpts from the investment accounts in the names of J. E. Cochran, Mabel Cochran, Sidney E. Cochran, Winifred Irwin (formerly Winifred Cochran), Bernice Johnson, (Mrs. Harold Johnson, formerly Bernice Cochran),

and Donald Cochran, respectively, on the books of partnership showing entries relating to transfers from one investment account to another during the period from December 31, 1937, to December 31, 1944, inclusive.

5. On March 15, 1938, J. E. Cochran filed a gift tax return for the year 1937 on which he reported gifts in the following words:

Description of Gift, Motive, and Donee's Name	Date of Gift	Value at Date of Gift
“(3½%) J.E.C. interest in Partner- ship Cochran & Celli Winifred, 8 Aztec Way, Oakland Love and Affection Sidney E. Cochran, 2927 - 76 Ave., Oakland..	Dec. 24	\$16,818.21
Mrs. Harold Johnson, Coalinga, Calif.	Dec. 24	16,818.21
“Children of Donor”		

On said return he claimed an exclusion of \$15,000.00 and a specific exemption of \$35,454.63, and reported no tax due and paid no tax thereon. On March 15, 1938, Mabel Cochran filed a gift tax return for the year 1937 showing the same donees, amounts, exclusions, and exemption as were shown on Joseph Cochran's return, and she also paid no gift tax for said year.

6. On or about January 1, 1938, the adult members of the Cochran and the Celli families mentioned in paragraph 2, *supra*, executed a document entitled “Articles of Copartnership,” a copy of

which is attached hereto and marked "Exhibit 7." On or about February 28, 1945, said parties and Donald Robert Cochran executed an amendment to said "Articles of Copartnership," a copy of which amendment is attached hereto and marked "Exhibit 8."

7. On or about January 1, 1938, Bernardo Celli, Jr., and Sidney Elmer Cochran executed a written declaration of trust, with the written consent of their wives. A copy of said declaration of trust is attached hereto and marked "Exhibit 9." Pursuant to said declaration of trust the real property described therein was conveyed to Bernardo Celli, Jr., and Sidney Elmer Cochran by deed dated January 1, 1938, and recorded February 23, 1938, at the request of the grantees, in Official Records Volume 3599, page 179, of Alameda County, State of California.

8. Attached hereto and marked "Exhibit 10" is a schedule showing the closing balances for each of the years 1937 through 1944 of each of the investment accounts maintained on the ledger of Cochran & Celli.

9. Attached hereto and marked "Exhibit 11" is a schedule showing the partners' earnings for services rendered, paid for each of the years 1938 through 1944 as shown on the salary accounts of Cochran & Celli.

10. Attached hereto and marked "Exhibit 12" is a summary of annual withdrawals charged to

individual accounts. These amounts are in addition to the withdrawals for services rendered shown in "Exhibit 11" and the transfers entered as gifts shown in Exhibits 1 to 6, inclusive.

11. Attached hereto and marked "Exhibit 13" and "Exhibit 14" are schedules showing the withdrawals charged to the Bernice Cochran Johnson and the Winifred Cochran Irwin accounts.

12. Attached hereto and marked "Exhibit 15" through "Exhibit 21" are balance sheets of Cochran & Celli for the years 1938 through 1944, respectively, prepared and certified to by Lawrence H. Goebel, Certified Public Accountant.

13. Attached hereto and marked "Exhibit 22" is a schedule of annual net profits reported on the Federal partnership information returns of Cochran & Celli for the years 1932 to 1944, inclusive.

14. Joseph E Cochran, Mabel Cochran, Bernice C. Johnson and Winifred C. Irwin each filed an individual Federal income tax return for each of the calendar years 1943 and 1944. On said returns they reported gross income, income from the partnership of Cochran & Celli, net income, and income tax due in the amounts shown in the following schedule:

	1943			
	Gross Income	Income from Partnership	Net Income	Tax Due
J. E. Cochran	\$20,777.36	\$20,777.36	\$19,756.31	\$8,822.06
Mabel Cochran	15,977.36	15,977.36	15,325.13	6,701.60
Bernice C. Johnson....	16,912.12	14,202.09	16,638.60	5,584.98
Winifred C. Irwin	15,910.30	14,202.09	15,605.32	5,481.02

1944

J. E. Cochran	\$20,370.77	\$20,370.77	\$19,832.73	\$7,467.23
Mabel Cochran	15,570.77	15,570.77	15,039.85	4,949.93
Bernice C. Johnson..	16,259.16	13,840.71	15,759.16	4,839.58
Winifred C. Irwin	15,551.95	13,840.70	15,051.95	4,955.98

The "Tax Due" in the above schedule for the year 1943 includes the unforgiven part of the 1942 tax. The "Income from Partnership" for the year 1944 includes a small amount of capital gain (\$318.30 or less) in each case.

/s/ ELI FREED,

/s/ EMMETT GEBAUER,

Counsel for Petitioner.

/s/ CHARLES OLIPHANT,

Chief Counsel, Bureau of Internal Revenue, Counsel
for Respondent.

EXHIBIT No. 1

Cochran & Celli

J. E. Cochran Investment Account

as

Transcribed from General Ledger

					Debit	Credit
Dec. 31, 1937	JV	469	Transfer to Mabel Cochran		\$100,617.43	
Dec. 31, 1937	JV	471	Transfer to Sidney E. Cochran		16,818.21	
Dec. 31, 1937	JV	471	Transfer to Winifred Cochran		16,818.21	
Dec. 31, 1937	JV	471	Transfer to Bernice Johnson		16,818.21	
Mar. 31, 1941	CD	46	Gift to Donald R. Cochran		4,000.00	
Mar. 31, 1942	CD	32	Gift to Donald R. Cochran		4,000.00	
Dec. 31, 1942	CD	115	Gift to Sidney E. Cochran		4,000.00	
Dec. 31, 1942	CD	115	Gift to Bernice Johnson		4,000.00	
Dec. 31, 1942	CD	115	Gift to Winifred Irwin		4,000.00	
Jan. 31, 1943	CD	10	Gift to Donald R. Cochran		3,000.00	
Jan. 31, 1943	CD	10	Gift to Sidney E. Cochran		3,000.00	
Jan. 31, 1943	CD	10	Gift to Bernice Johnson		3,000.00	
Jan. 31, 1943	CD	10	Gift to Winifred Irwin		3,000.00	
Apr. 30, 1944	CD	33	Gift to Donald R. Cochran		3,000.00	
Apr. 30, 1944	CD	33	Gift to Sidney E. Cochran		3,000.00	
Apr. 30, 1944	CD	33	Gift to Bernice Johnson		3,000.00	
Apr. 30, 1944	CD	33	Gift to Winifred Irwin		3,000.00	

The above entries are posted from the Journal (JV) and Cash Disbursements Book (CD).

EXHIBIT No. 2

Cochran & Celli

Mabel Cochran Investment Account

as

Transcribed from General Ledger

				Debit	Credit
					\$100,617.43
Dec. 31, 1937	JV	469	From J. E. Cochran, Investment		
Dec. 31, 1937	JV	472	Transfer to Sidney E. Cochran	\$ 16,818.21	
Dec. 31, 1937	JV	472	Transfer to Winifred Cochran	16,818.21	
Dec. 31, 1937	JV	472	Transfer to Bernice Johnson	16,818.21	
Mar. 31, 1941	CD	46	Gift to Donald R. Cochran	4,000.00	
Mar. 31, 1942	CD	32	Gift to Donald R. Cochran	4,000.00	
Dec. 31, 1942	CD	115	Gift to Sidney E. Cochran	4,000.00	
Dec. 31, 1942	CD	115	Gift to Bernice Johnson	4,000.00	
Dec. 31, 1942	CD	115	Gift to Winifred Cochran	4,000.00	
Jan. 31, 1943	CD	10	Gift to Sidney E. Cochran	3,000.00	
Jan. 31, 1943	CD	10	Gift to Donald R. Cochran	3,000.00	
Jan. 31, 1943	CD	10	Gift to Bernice Johnson	3,000.00	
Jan. 31, 1943	CD	10	Gift to Winifred Irwin	3,000.00	
Apr. 30, 1944	CD	33	Gift to Sidney E. Cochran	3,000.00	
Apr. 30, 1944	CD	33	Gift to Donald R. Cochran	3,000.00	
Apr. 30, 1944	CD	33	Gift to Bernice Johnson	3,000.00	
Apr. 30, 1944	CD	33	Gift to Winifred Irwin	3,000.00	

The above entries are posted from the Journal (JV) and Cash Disbursements Book (CD).

EXHIBIT No.3

Cochran & Celli

Sidney E. Cochran Investment Account

as

Transcribed from General Ledger

					Debit	Credit
Dec. 31, 1937	JV	471	By Gift from J. E. Cochran			\$ 16,818.21
Dec. 31, 1937	JV	471	By Gift from Mabel Cochran			16,818.21
Mar. 31, 1941	CD	54	Gift to Donald R. Cochran	4,000.00		
Mar. 31, 1942	CD	32	Gift to Donald R. Cochran	4,000.00		
Dec. 31, 1942	CR	72	Gift from J. E. Cochran		4,000.00	
Dec. 31, 1942	CR	72	Gift from Mabel Cochran		4,000.00	
Jan. 31, 1943	CR	5	Gift from Mabel Cochran		3,000.00	
Jan. 31, 1943	CR	5	Gift from J. E. Cochran		3,000.00	
Jan. 31, 1943	CD	10	Gift to Donald R. Cochran	2,500.00		
Apr. 30, 1944	CR	23	Cash Paid In		6,000.00	

The above entries are posted from the Journal (JV), and Cash Disbursements Book (CD), and the Cash Receipts Book (CR).

EXHIBIT No. 4

Cochran & Celli

Winifred Irwin Investment Account

as

Transcribed from General Ledger

				Debit	Credit
Dec. 31, 1937	JV	471	Gift from J. E. Cochran		\$ 16,818.21
Dec. 31, 1937	JV	471	Gift from Mabel Cochran		16,818.21
Mar. 31, 1941	CD	46	Gift to Donald R. Cochran	4,000.00	
Mar. 31, 1942	CD	32	Gift to Donald R. Cochran	4,000.00	
Dec. 31, 1942	CR	72	Gift from J. E. Cochran		4,000.00
Dec. 31, 1942	CR	72	Gift from Mabel Cochran		4,000.00
Jan. 31, 1943	CR	5	Gift from J. E. Cochran		3,000.00
Jan. 31, 1943	CR	5	Gift from Mabel Cochran		3,000.00
Jan. 31, 1943	CD	10	Gift to Donald R. Cochran	2,500.00	
Apr. 30, 1944	CR	23	Cash Paid In		6,000.00

The above entries are posted from the Journal (JV), and Cash Disbursements Book (CD), and the Cash Receipts Book (CR).

EXHIBIT No. 5

Cochran & Celli

Bernice Johnson Investment Account

as

Transcribed from General Ledger

				Debit	Credit
Dec. 31, 1937	JV	471	Gift from J. E. Cochran		\$ 16,818.21
Dec. 31, 1937	JV	471	Gift from Mabel Cochran		16,818.21
Mar. 31, 1941	CD	46	Gift to Donald R. Cochran	\$ 4,000.00	
Mar. 31, 1942	CD	32	Gift to Donald R. Cochran	4,000.00	
Dec. 31, 1942	CR	72	Gift from J. E. Cochran		4,000.00
Dec. 31, 1942	CR	72	Gift from Mabel Cochran		4,000.00
Jan. 31, 1943	CR	5	Gift from J. E. Cochran		3,000.00
Jan. 31, 1943	CR	5	Gift from Mabel Cochran		3,000.00
Jan. 31, 1943	CD	10	Gift to Donald R. Cochran	2,500.00	
Apr. 30, 1944	CR	23	Cash Paid In		6,000.00

The above entries are posted from the Journal (JV), and Cash Disbursements Book (CD), and the Cash Receipts Book (CR).

EXHIBIT No. 6

Cochran & Celli

Donald R. Cochran Investment Account

as

Transcribed from General Ledger

			Debit	Credit
Mar. 31, 1941	CR	23	Cash Paid In	\$20,000.00
Mar. 31, 1942	CR	20	Cash Paid In	20,000.00
Jan. 31, 1943	CR	5	Cash Paid In	13,500.00
Apr. 30, 1944	CR	23	Cash Paid In	6,000.00

The above entries are posted from the Cash Receipts Book (CR).

EXHIBIT No. 7

These Articles of Co-partnership made and entered into this first day of January, 1938, by and between J. E. Cochran, Mabel Cochran, Bernice M. Cochran, Winifred Cochran, Sidney Elmer Cochran, Bernardo Celli, Sr., Anna Celli, Bernardo Celli, Jr., and Lloyd Celli, all of the County of Alameda, State of California,

Witnesseth:

1. That the said parties above named are the owners of that certain business conducted under the firm name and style of Cochran & Celli, and that the said parties have agreed and by these presents do agree to become co-partners in the said business and to continue to conduct the same under the firm name and style of Cochran & Celli, and that the said business shall deal with the buying, selling, manufacturing and repairing of new and used automobiles, parts, automotive vehicles and equipment, and generally shall deal in all things connected with or incidental to the automobile business; and

that the principal place for the conduct of said business shall be in the City of Oakland, County of Alameda, State of California.

2. It is mutually understood that the above-mentioned business was formerly owned and conducted by J. E. Cochran and Bernardo Celli, Sr., as co-partners, and that the parties hereto are the successors to the above-mentioned co-partnership and said parties and each of them hereby agree that they will be and are liable for, and will pay or perform any and all valid obligations, liabilities, or contracts, heretofore created or incurred in the name of and by the said co-partnership as and when owned by the said J. E. Cochran and Bernardo Celli, Sr.

3. It is understood and agreed by and between the said co-partners that they and each of them have contributed to the said co-partnership such portion, and that they and each of them own such portion in and of the said business as is designated by the percentage figure hereafter set out after their respective names:

J. E. Cochran	19.11% interest
Mabel Cochran	10.44% interest
Bernice M. Cochran.....	7.00% interest
Winifred Cochran	7.00% interest
Sidney Elmer Cochran...	7.00% interest
Bernardo Celli, Sr.	18.22% interest
Anna Celli	11.23% interest
Bernardo Celli, Jr.	10.00% interest
Lloyd Celli	10.00% interest

4. It is mutually agreed that any co-partner may transfer and convey to any other co-partner or to Donald Robert Cochran upon his attaining legal age, all or any portion of his interest in this said co-partnership, it being agreed that any such transfer may be accomplished by an instrument in writing signed by the transferor and accepted by the transferee, an executed copy of which said instrument shall be attached to and made a part of this agreement and thereafter the above-designated interest shall be considered as amended accordingly; provided, however that if transfer be made to Donald Robert Cochran, this partnership shall be deemed to have opened up to include him and all provisions hereof shall become applicable to him as a co-partner upon his signing and consenting in writing to the terms and conditions hereof and otherwise fully complying herewith.

5. It is hereby agreed that J. E. Cochran and Bernardo Celli, Sr., shall have, and are hereby given, the exclusive management and control of the conduct of said business and of any and all matters pertaining thereto, and the sole and exclusive power and authority to employ and discharge the employees of said co-partnership, and any and all thereof, including each and all of his co-partners herein as such employees; and to fix any and all salaries, including those of themselves and other co-partners; and the sole and exclusive power and authority to sign any and all checks, promissory notes or other evidence of indebtedness of said co-partnership; and the sole and exclusive power

and authority to collect and distribute the assets and profits of said co-partnership among and between the said co-partners, or any of them, and to make payment thereof, or of any part or portion thereof, to said respective co-partners; and the sole and exclusive authority to determine the necessity for, and to levy and collect assessments from the respective co-partners to provide for payment of losses or expenses; and the sole and exclusive power and authority to incur indebtedness for and in behalf of said co-partnership, and to make any and all contracts and agreements for and on behalf of said co-partnership, and to settle, adjust and compromise any and all disputes, claims and demands of whatsoever kind or nature in connection with said co-partnership or said co-partnership business; and generally, to do and perform any and all things necessary to be done or performed for the successful conduct, management, and control of said co-partnership business, including the right to delegate to others the power to exercise all or any of the said functions; and in so managing and controlling said business, and in the performance of said duties, as aforesaid, the said J. E. Cochran and Bernardo Celli, Sr., and their successors as hereinafter provided for, will give their attendance, and to the utmost of their ability exert themselves for the joint interest, benefit and advantage of the parties hereto; said controlling parties or their said successors shall hereinafter be designated as "Managers."

6. It is understood and agreed that an account-

ing shall be had at the close of each calendar year, and the net profits or losses of the said business determined, adjusted and distributed and partitioned or assessed to and among the co-partners in the same proportionate amount as their respective interests bear to the entire business, provided that the said "Managers" may, if they deem it advisable, set aside a portion of, or all of any said profits as a reserve for such purpose or purposes as may be deemed advisable by them. It is understood however that nothing herein shall prevent the distribution of profits or assessment of losses more often than the interval of one year, as above specified. The parties hereto and each of them, expressly agree to pay any such assessment within fifteen days of notice thereof.

7. The parties hereto, and each of them, hereby agree that they will immediately make and execute a good and sufficient will, and will thereafter as long as this co-partnership exists, continue to keep such a will in existence, and that the terms of any such will shall be such that the respective interest of the declaring co-partner in this co-partnership business will be allocated and devised to the particular beneficiaries desired by the declaring co-partner in fractional or percentage amounts, and that all of his or her interest will be devised in this manner. Said will shall further declare and designate that any and all other assets of the declarant's said estate (except a homestead for a surviving spouse or minor children) shall be first

exhausted in the payment of debts, claims, taxes in connection with the said estate, and expenses of administration.

8. It is hereby understood and agreed that upon the death of any of the aforesaid co-partners, the business of this co-partnership shall be continued and conducted by the surviving co-partners, and that in the event the interest or any part thereof, of the deceased co-partner is devised or bequeathed to any of the surviving co-partners, then the interest in the co-partnership of any such beneficiary shall be increased by the amount so devised or bequeathed. It is further agreed that in the event any interest in this co-partnership shall be devised or bequeathed to any one other than a co-partner, then and in that event the said individual or individuals shall become limited partners in the co-partnership business to the extent of the interest as devised or bequeathed, and the parties hereto agree that in any such event they will immediately prepare and execute in the manner required by law a certificate of limited partnership, setting forth the respective rights of the co-partners, both general and limited, and that the business of this co-partnership shall thereafter be carried on by the said limited co-partnership under the same firm name, and the said limited co-partnership shall become the successor in all respects of the firm business and assets, assuming all obligations, liabilities and contracts, and obtaining all credits and benefits thereof.

9. It is further agreed that in the event the above-mentioned J. E. Cochran or Bernardo Celli, Sr., or any partner, designated as "Managers" under Paragraph "5" above, shall die, then and in that event the right of control to the extent vested in the said individual shall be vested in the eldest surviving male partner, of the same family as the deceased co-partner, and he shall be entitled to exercise all control and do all things previously done by the deceased co-partner.

10. The parties hereto hereby agree that they and each of them will immediately obtain and at all times hereafter, as long as this co-partnership exists, keep in effect a policy of life insurance upon their respective lives in an amount (over and above any loans on the policy itself) not less than \$3,000.00 in excess of any and all obligations (exclusive of those owned by the co-partnership (owing or which shall hereafter become owing by the said partner, and that the said policy of insurance shall be carried in a reputable company and shall designate as the beneficiary the estate of the particular co-partner. It is understood that as an alternative requirement to the obtaining and keeping of such a policy, the co-partner may keep on hand at all times cash or liquid assets the reasonable market value of which exceeds the said obligations by the said sum of \$3,000.00.

11. If it appears upon the death of any co-partner that there are insufficient moneys in the estate of such co-partner to satisfy all valid claims

against his or her said estate, taxes in connection therewith, and all expenses and charges of administration therein, then and in that event the surviving co-partners shall be entitled, at their option, to advance to the said estate sufficient moneys to liquidate any and all such claims or expenses, and to thereafter deduct the amount so advanced, with interest thereon at the rate of six per cent, from any and all profits payable upon the interest of the deceased partner, by whomsoever owned, until the said advances are fully repaid.

12. The term of this co-partnership shall be one year from date hereof, it being agreed, however, that if no co-partner indicates his desire to dissolve this co-partnership by notice in writing given to the co-partnership at its principal office in Oakland, at least thirty days before the termination of the said year, or any following year, as in this paragraph provided, then and in that event this co-partnership shall be continued from year to year thereafter.

13. If any co-partner or co-partners shall elect to retire from the co-partnership before the end of the term fixed for its duration, then and in that event such party shall give to the other parties notice in writing of his election to retire, and such retirement shall then be effective on the last day of the next succeeding calendar month, which day shall occur more than thirty days from the delivery of said notice, to the principal office of the business of this co-partnership in Oakland, and the said

co-partnership shall thereupon be dissolved, provided, however, that the other co-partners, if their combined ownership is more than fifty per cent of the business, may at their election continue the said business, provided, that notice in writing of such election shall be served upon the retiring co-partner or co-partners, and that as a condition thereof payment shall be made to the retiring co-partner or co-partners of the following amounts and at the following times:—sixty days after the effective date of the retirement, a sum equal to ten per cent of the book value of his or her proportionate interest in the business, as determined on the effective date of retirement; a further sum equal to ninety per cent of his proportionate interest of the book value of the business as of said date to be paid within a period of five years from the effective date of retirement, together with interest on the unpaid portions thereof at the rate of five per cent per annum, it being agreed that not less than one-fifth of said sum shall be paid each year thereafter, provided, further that if the said business shall be terminated or dissolved after the effective date of any such withdrawal and prior to the completion of said payments, then any such retiring co-partner shall be entitled to participate as a general creditor in the assets of said co-partnership to the extent of any unpaid balance. Each co-partner hereby expressly agrees to accept and receive an amount as above fixed, paid in the manner above specified, as and for his full share and interest in the co-partnership, in the event of his

withdrawal, and that the interest of such retiring co-partners shall be so divided among the remaining co-partners that their relative interests shall remain the same.

14. It is further agreed that in the event co-partners owning more than fifty per cent of the business elect to continue the operation of the business at the end of any yearly period, and other interests owning less than fifty per cent of the business desire to withdraw or discontinue, and have indicated such desire in the manner herein specified in Paragraph "12," then and in that event the co-partners so desiring may continue the business and pay off the other co-partners in the same manner and at the same rates and in the same amounts as provided for retiring co-partners, in the paragraph immediately next preceding; the last day of the calendar year to be considered as the effective date of retirement.

15. Any retirement or election to discontinue hereunder, as herein provided, may be retracted by the party so signifying by a notice in writing given to the co-partnership at its principal office in Oakland at any time more than five days before the effective date of such election.

16. Any retiring co-partner, within the meaning of Paragraphs "13" and "14" above, after the effective date of such withdrawal or retirement, shall be deemed to have assigned, transferred and set over unto the continuing parties all of his right, title and interest in and to the said co-partnership,

the good will, firm name, and any and all other assets thereof, without any further act upon the part of such retiring party, and he or she further agrees to do all further acts and execute all documents or papers which may be deemed necessary or proper to accomplish the same, without charge or cost.

17. Such retiring co-partner shall not at any time solicit or deal with in a competitive capacity, any of the customers or business associates of the partnership, or of any of the continuing parties, and shall not at any time disclose to any person, firm or corporation the names of any customers or business associates of the co-partnership, or any of its transactions, and such retiring co-partner shall not, at any time, use the firm name, nor either in conjunction with his own name, or otherwise, use the words "formerly of Cochran & Celli," or any other combination of words containing the firm name, and such retiring co-partner further agrees that he will not own, manage or engage in any business in competition with the co-partnership business within the County of Alameda, State of California, so long as the said co-partnership shall continue and exist under the same firm name and have as members the same co-partners, or any of them, or their successors and assigns, or a corporation which shall be a successor or assign, provided, however, that this restriction shall not exceed the period of fifteen years.

18. If any co-partner shall be guilty of mis-

conduct of such a character as to render it impracticable for the co-partners to carry on the partnership business together, then and in that event the offending co-partner may be expelled from the co-partnership by the unanimous vote of the remaining members of the co-partnership upon payment to him in the same manner and at the same times and in the same amounts as a retiring partner under Paragraph "13" above, it being understood that the effective date of said expulsion shall be the last day of a calendar month next occurring which is not less than thirty days from the date of notice thereof given to the offending co-partner, provided, however, that if the ownership of the offending co-partner in the partnership business is more than fifty per cent thereof, the co-partnership shall be dissolved. Any such expelled party shall be bound by the same terms, conditions, covenants and restrictions as hereinabove set forth for the retiring co-partner in Paragraphs "16" and "17" hereof.

19. It is expressly understood and agreed that none of the co-partners, other than as expressly set forth herein, shall have the power and authority to bind his or her co-partners, or to sell or assign or transfer his or her co-partnership interest therein.

20. It is expressly agreed that no co-partner shall engage in or become directly interested in, at any time during the existence of this co-partnership, any business or undertaking which gives him

or her an interest adverse to that of said co-partnership, (except any such interest as shall exist as of date hereof), without written consent of the other co-partners first obtained.

21. It is further understood and agreed that there shall be kept at all times during the continuance of this co-partnership just and true books of account wherein shall be set down any and all moneys received or expended in or about said business, and also all property, real or personal, bought, sold or exchanged by reason of or on account of said business, and all matters and things whatsoever concerning said business and management thereof, or in any way appertaining thereto, access to which said books of account may be had by any of the co-partners at any reasonable time during said co-partnership and while said respective co-partners own and possess a co-partnership interest in said business under and by virtue of the terms of this contract and agreement.

22. Any co-partner who shall violate any of the terms, provisions and conditions of this agreement shall, in addition to being subjected to the other remedies, liabilities and obligations herein or by law imposed upon him, thereafter, keep and save harmless the co-partnership property and shall indemnify the other co-partners from any and all claims and actions which may arise out of or by reason of such a violation of any of the terms, provisions and conditions hereof.

23. Upon the termination of this co-partnership

at the expiration of its term, or upon the happening of any contingency requiring dissolution, as otherwise hereinabove provided for, the parties designated as "Managers" shall then become Trustees for all the co-partners and they shall thereupon proceed to liquidate the assets of the co-partnership as rapidly as is reasonable and practicable under the circumstances, and shall as often as is practicable distribute the proceeds of such liquidation to the co-partners in accordance with their respective interests therein.

24. It is hereby agreed that all real assets of this co-partnership shall immediately be transferred to and held in the names of Bernard Celli, Jr., and Sidney Elmer Cochran, in trust for the benefit of this co-partnership and/or its successors or assigns, and subject to the terms and conditions of this agreement; that such successor or substituted Trustees may be designated as, and substituted in the place and stead of above named Trustees or either of them as and when deemed necessary by the beneficiaries of the trust; and said Trustees and each of them hereby agree to do all things necessary and proper to accomplish the purposes herein expressed, without cost or charge other than for reasonable reimbursement for expenses incurred.

25. This agreement shall be and is binding upon the heirs, executors, administrators, successors and assigns of each and all of the parties hereto.

In Witness Whereof, the parties hereto have unto an original hereof, and to six copies, affixed their names and seals the day and year hereinabove first written.

/s/ J. E. COCHRAN,

/s/ MABEL COCHRAN,

/s/ BERNARDO CELLI, SR.,

/s/ ANNA CELLI,

/s/ BERNARDO CELLI, JR.,

/s/ LLOYD CELLI,

/s/ S. E. COCHRAN,

/s/ BERNICE COCHRAN,

/s/ WINIFRED COCHRAN.

EXHIBIT No. 8

Amendment to Articles of Co-Partnership

Agreement made this 28th day of February, 1945, between J. E. Cochran, Mabel Cochran, Sidney Elmer Cochran, Winifred Cochran Irwin, Bernice Cochran Johnson, Donald Robert Cochran, Bernardo Celli, Sr., Anna Celli, Bernardo Celli, Jr., and Lloyd Celli, all of the County of Alameda, State of California;

Whereas, Articles of Co-partnership were made January 1, 1938, by all of the parties hereto excepting Donald Robert Cochran, for the ownership and operation of the business of Cochran & Celli as a partnership; and

Whereas, paragraph numbered 4 of said agreement or articles of co-partnership permits internal transfers of shares and interests in said co-partnership among the partners, and also provides for the admission of Donald Robert Cochran as a partner without interruption of the business of Cochran & Celli; and

Whereas, Winifred Cochran, mentioned in said articles of co-partnership, is the same person as Winifred Cochran Irwin, one of the partners and a party hereto; and

Whereas, Bernice M. Cochran, mentioned in said articles of co-partnership, is the same person as Bernice Cochran Johnson, one of the partners and a party hereto; and

Whereas, Donald Robert Cochran was admitted as a partner in the year 1941, causing a temporary dissolution of said partnership at the time of his admission and a reorganization and continuation of the business of Cochran & Celli by reason of his admission as a partner; and

Whereas, there was no formal dissolution of said partnership at the time of the so-called admission of Donald Robert Cochran as a partner but, on the other hand, a reorganization of a new partnership among the same parties, adding to the association of the parties, Donald Robert Cochran as a partner; and

Whereas, preceding the reorganization and subsequent to such reorganization, there have been partial internal transfers of partnership shares and interests among the partners, as reflected in the

books of such partnership by adjustments in the appropriate proprietorship accounts of the partners; and

Whereas, it is now the desire and the intention of the parties to affirm said admission of Donald Robert Cochran and said transfers and adjustments, and to clarify the intentions of the parties from the inception of said co-partnership and said reorganization, and amend said articles of co-partnership;

It Is, Therefore, Agreed:

1. It is understood that the preamble aforesaid to this agreement expresses the intentions of the parties hereto as though part of the operating provisions hereof.

2. It is understood that the nature of the "interest" of each partner of Cochran & Celli, reflected in terms of percentages in the articles of co-partnership, dated January 1, 1938, and herein, is the partner's share of the profits and earned surplus of the partnership business, and the "interest" of a partner shall not be deemed to have any necessary relationship to the proprietary share of net worth of a partner.

3. That the procedures provided in paragraph numbered 4 of said articles of co-partnership, dated January 1, 1938, notwithstanding, the interests of the parties hereto in Cochran & Celli since January 1, 1938, are declared to be in the following adjusted percentages:

1938

J. E. Cochran	18.91
Mabel Cochran	10.33
Sidney Elmer Cochran	6.92
Winifred Cochran	6.92
Bernice Cochran Johnson	6.92
Bernardo Celli, Sr.	18.42
Anna Celli	11.36
Bernardo Celli, Jr.	10.11
Lloyd Celli	10.11

1939

J. E. Cochran	17.48
Mabel Cochran	10.80
Sidney Elmer Cochran	7.24
Winifred Cochran	7.24
Bernice Cochran Johnson	7.24
Bernardo Celli, Sr.	14.70
Anna Celli	9.90
Bernardo Celli, Jr.	12.70
Lloyd Celli	12.70

1940

J. E. Cochran	14.286
Mabel Cochran	14.285
Sidney E. Cochran	7.143
Winifred Cochran	7.143
Bernice Cochran Johnson	7.143
B. Celli, Sr.	13.67
Anna Celli	10.21
B. Celli, Jr.	13.06
Lloyd Celli	13.06

1941

J. E. Cochran	13.333
Mabel Cochran	13.333
Sidney E. Cochran	6.667
Winifred Cochran	6.667
Bernice Cochran Johnson	6.667
Donald Robert Cochran	3.333
B. Celli, Sr.	13.14
Anna Celli	10.40
B. Celli, Jr.	13.23
Lloyd Celli	13.23

1942

J. E. Cochran	12.5
Mabel Cochran	12.5
Sidney E. Cochran	6.25
Winifred Cochran Irwin	6.25
Bernice Cochran Johnson	6.25
Donald Robert Cochran	6.25
B. Celli, Sr.	12.5
Anna Celli	12.5
B. Celli, Jr.	12.5
Lloyd Celli	12.5

1943

J. E. Cochran	9.0
Mabel Cochran	9.0
Sidney E. Cochran	8.0
Winifred Cochran Irwin	8.0
Bernice Cochran Johnson	8.0
Donald Robert Cochran	8.0
B. Celli, Sr.	12.5
Anna Celli	12.5
B. Celli, Jr.	12.5
Lloyd Celli	12.5

4. Donald Robert Cochran agrees that upon his association with all of the other parties hereto as a partner in the partnership of Cochran & Celli, and ever since and hereafter, he has been, now is and will be bound by all of the provisions of said articles of co-partnership just as though he were an original signatory thereto. It is not meant hereby, however, that there was no legal interruption of the existence of the partnership of Cochran & Celli as constituted January 1, 1938, at the time of the association of Donald Robert Cochran with the other parties hereto in the year 1941. On the other hand, it is understood that a new partnership was formed on the terms and conditions of said articles of co-partnership when Donald Robert Cochran became a partner in the partnership of Cochran & Celli.

5. The requirement in paragraph numbered 4 of said articles of co-partnership providing that internal transfers of partnership interests shall be accomplished by an instrument in writing signed by the transferor and executed by the transferee, and that an executed copy of such instrument shall be attached to and made part of said articles of co-partnership, is hereby waived with respect to all of such transfers and adjustments made prior to January 1, 1944.

6. There is hereby substituted for paragraph numbered 8 of said articles of co-partnership as though originally therein, and this amendment shall be binding upon the parties hereto, the following:

“It is hereby agreed that upon the death of any of the partners of Cochran & Celli, the business of such partnership shall not be interrupted by reason of such death, but such business shall be continued and conducted by the surviving partners. It is, nevertheless, understood that the death of any of the partners shall dissolve and terminate the existence of the partnership. However, the business of said partnership shall be continued for the purposes provided for herein. For the purpose of continuing the operation of said business without interruption and preserving the value thereof, the surviving partners shall not be required to wind up and settle the partnership business as provided in California Probate Code, Section 571, but may continue the operation of said business without regard to California Probate Code, Section 571, until such time as it appears that the purposes provided for herein cannot be accomplished. If after the death of any of the partners and the dissolution of the partnership by reason of such death, it appears that the share and interest, or any part thereof, of the deceased partner has been devised or bequeathed to any of the surviving partners, in such case, a new partnership shall be organized without interruption of the business, however, and in accordance with the provisions of this agreement, adjusting any increase in the proprietorship share and interest of any surviving partner or partners who may be the devisee or legatee of such deceased partner. If upon the death of any partner and the dissolution of the partner-

ship by reason thereof, it appears that the deceased partner has attempted to devise or bequeath the proprietorship share and interest of such deceased partner to any person or persons other than a partner herein, in such case the business shall be reorganized (and continued) by the formation of a limited partnership under the laws of the State of California, and such devisee or legatee (singular or plural as the case may be) to whom the deceased partner has devised or bequeathed his proprietary share and interest in the partnership, shall, if agreed upon, become a limited partner or partners and the surviving partners shall be the general partners. It is expressly understood that none of the partners shall devise or bequeath their interest in any good will attaching to the partnership business of Cochran & Celli but that in the case of the death of any partner or partners, the surviving partners shall be and become the sole and exclusive owners of any good will of said business, and good will shall not be or become part of the value or assets of the estate of any such deceased partner or partners."

7. In order to clarify the intention of the parties as expressed in paragraph numbered 24 of said articles of co-partnership, said articles of co-partnership are hereby amended by substituting for paragraph numbered 24 as though originally therein, the following language, to wit:

"In order to facilitate the holding and transfer of the title of the partners to all real property of the co-partnership, it is hereby agreed that all real

property of this co-partnership shall immediately be transferred to and held in the names of Bernardo Celli, Jr., and Sidney Elmer Cochran, in trust, for the benefit of this co-partnership, subject to the terms and conditions of this agreement. Successor or substituted trustees may be appointed and substituted in the place and stead of the above-named trustees, or either of them, by a majority of the partners (at least two members of the Celli group being in such majority) as, if and when deemed necessary. Said trustees, and each of them, are hereby empowered and agree to do all things necessary and proper to accomplish the purposes herein expressed; however, in acting, said trustees, although nominal trustees, shall at all times, nevertheless, be regarded as partners of this co-partnership with the powers and duties aforesaid."

8. It is agreed that said trustees, their successors and assigns shall hold title to the real property of the partnership in behalf of Donald Robert Cochran as his interest may appear, as well as for all of the other partners thereof.

9. That certain instrument in writing, dated January 1, 1938, entitled "Declaration of Trust," which is by its terms a holding agreement, signed by Bernardo Celli, Jr., and S. E. Cochran, and approved and made binding upon the wives of said parties by virtue of their written consent, viz., the consent of Melva Celli and Marian Cochran, which agreement was made pursuant to paragraph numbered 24 of said articles of co-partnership, is

hereby made subject to and shall be controlled by paragraphs numbered 7 and 8 aforesaid of this agreement amending said articles of co-partnership.

In Witness Whereof, the parties hereto have set their hands the day and year first above written.

/s/ J. E. COCHRAN,

/s/ MABEL COCHRAN,

/s/ SIDNEY ELMER COCHRAN,

/s/ WINIFRED COCHRAN
IRWIN,

/s/ BERNICE COCHRAN
JOHNSON,

/s/ DONALD ROBERT
COCHRAN,

/s/ BERNARDO CELLI, SR.,

/s/ ANNA CELLI,

/s/ BERNARDO CELLI, JR.,

/s/ LLOYD CELLI.

EXHIBIT No. 9

Declaration of Trust

We, Bernardo Celli, Jr., and Sidney Elmer Cochran, and each of us, do hereby expressly declare that we have received and do now hold that certain real property as fully described in Exhibit "A" attached hereto and made a part hereof for the use and benefit of Cochran & Celli, a co-partnership, its successors and assigns, and subject to

all the terms and conditions of that certain agreement of co-partnership made and entered into on the 1st day of January, 1938, by and between J. E. Cochran, Mabel Cochran, Bernice M. Cochran, Winifred Cochran, Sidney Elmer Cochran, Bernardo Celli, Sr.; Anna Celli, Bernardo Celli, Jr., and Lloyd Celli.

Dated this 1st day of January, 1938.

/s/ BERNARDO CELLI, JR.,

/s/ S. E. COCHRAN.

We, the undersigned, being the respective wives of the aforesaid Bernardo Celli, Jr., and Sidney Elmer Cochran, do hereby expressly acknowledge that the real property as aforesaid mentioned, and described in Exhibit "A" as attached hereto is held by our said husbands in trust for the purposes as above set forth, and we do expressly agree that we, and each of us, will execute any and all documents, instruments, and papers required of us for the purpose of carrying out or furthering the trusts aforesaid without charge, cost or expense, except for reasonable reimbursement for sums expended to this end.

Dated January 1st, 1938.

/s/ MELVA CELLI, JR.,

Wife of Bernardo Celli, Jr.;

/s/ MARIAN COCHRAN,

Wife of Sidney Elmer
Cochran.

EXHIBIT "A"

All that certain real property situate, lying and being in the City of Oakland, County of Alameda, State of California, and particularly described as follows, to wit:

Parcel 1: Beginning at a point on the Northwestern line of 9th Avenue, distant thereon Southwesterly 75 feet from the point of intersection thereof with the Southwestern line of East 11th Street; running thence Southwesterly along said line of 9th Avenue, 75 feet; thence Northwesterly parallel with East 11th Street, 150 feet; thence Northeasterly parallel with 9th Avenue, 75 feet; thence Southeasterly parallel with East 11th Street, 150 feet to the point of beginning.

Being a portion of Block #18, as per Higley's Map of Clinton of record in Liber B of Deeds, page 537, in the office of the County Recorder of Alameda County.

Parcel 2: Beginning at the intersection of the Southwestern line of East 11th Street, formerly Jackson Street, with the Northwestern line of 9th Avenue, formerly Clay Street, as the said Streets are shown upon the Map hereinafter referred to; running thence Southwesterly along said line of 9th Avenue 75 feet; thence at right angles Northwesterly 150 feet; thence at right angles Northeasterly 75 feet to the said Southwestern line of East 11th Street; and thence Southeasterly along said last-named line 150 feet to the point of beginning.

Being a portion of Block #18, as the said Block is delineated and so designated upon Higley's Map

of Clinton, of record in Liber "B" of Deeds, page 537, in the office of the County Recorder of the said County of Alameda.

Parcel 3: Beginning at a point on the Northeastern line of East 11th Street, distant thereon Northwesterly 150 feet from the intersection thereof with the Northwestern line of 9th Avenue; running thence Northwesterly along said line of East 11th Street, 50 feet; thence at right angles Northeasterly 150 feet; thence at right angles Southeasterly 50 feet; and thence at right angles Southwesterly 150 feet to the point of beginning.

Being a portion of Block #34 as said Block is delineated and so designated upon Higley's Map of Clinton of record in Liber "B" of Deeds, at page 537, in the office of the County Recorder of Alameda County.

Parcel 4: Beginning at the intersection of the Southeastern line of 8th Avenue, with the Northeastern line of East 11th Street; running thence Northeasterly along said line of 8th Avenue, 113 feet; thence Southeasterly parallel with said line of East 11th Street, 100 feet; thence Southwesterly parallel with said line of 8th Avenue 113 feet to the Northeastern line of East 11th Street, and thence Northwesterly along said last-named line 100 feet to the point of beginning.

Being a portion of Block #34, as the said Block is delineated and so designated upon Higley's Map of Clinton of record in Liber "B" of Deeds, at page 537, in the office of the County Recorder of the County of Alameda.

Parcel 5: Beginning at a point on the Southeastern line of 8th Avenue, distant thereon Northeasterly 113 feet from the intersection thereof with the Northeastern line of East 11th Street; running thence Northeasterly along said line of 8th Avenue 37 feet; thence Southeasterly parallel with said line of East 11th Street 100 feet; thence Southwesterly parallel with said line of 8th Avenue 37 feet; and thence Northwesterly parallel with said line of East 11th Street, 100 feet to the point of beginning.

Being a portion of Block #34, as the said Block is delineated and so designated upon Higley's Map of Clinton of record in Liber "B" of Deeds, at page 537, in the office of the County Recorder of Alameda County.

Parcel 6: Beginning at a point on the Northern line of 5th Street, distant thereon 67.11 feet Easterly from the point of intersection thereof with the Eastern line of Broadway, said point of beginning being also the Southeastern corner of that certain parcel of land conveyed by J. R. Cochran, B. Celli, et al., to Eugene Moffat Investment Company, a corporation, by deed dated November 9, 1923, recorded in Liber 530 of Official Records, at page 441; running thence Easterly along said line of 5th Street 24 feet 8½ inches; thence at right angles Northerly 50 feet; thence at right angles Easterly 10.38 feet; thence at right angles Northerly 40 feet; thence at right angles Westerly 25 feet; thence at right angles Southerly 40 feet; thence at right angles Westerly 10.09 feet to the Eastern line of

said parcel of land conveyed to said Eugene Moffat Investment Company, by the deed hereinabove referred to; thence Southerly along said last-named line 50 feet to the point of beginning.

Being a portion of Lots Numbered 1, 2, 27 and 28 in Block #55, as said Lots and Block are laid down and delineated upon Kellersberger's Map of Oakland, on file and of record in the office of the County Recorder of Alameda County.

Parcel 7: Beginning at a point on the Northern line of 5th Street, distant thereon 91.82 feet Easterly from the point of intersection thereof with the Eastern line of Broadway; running thence Easterly along said line of 5th Street, 133.18 feet; thence at right angles Northerly 100 feet; thence at right angles Westerly 125 feet; thence at right angles Southerly 10 feet; thence at right angles Easterly 2.20 feet; thence at right angles Southerly 40 feet; thence at right angles Westerly 10.38 feet; thence at right angles Southerly 50 feet to the point of beginning.

Being Lots numbered 23, 24, 25 and 26, and portions of Lots numbered 27 and 28 in Block #55, as said Lots and Block are laid down and delineated upon Kellersberger's Map of Oakland on file and of record in the office of the County Recorder of Alameda County.

Parcel 8: Lots numbered 12 and 13 in Block #55, as said Lots and Block are laid down and delineated upon Kellersberger's Map of Oakland on file and of record in the office of the County Recorder of Alameda County.

Parcel 9: Beginning at a point bearing North 17 degrees, 11' 05" East 75.54 feet from the most Northerly corner of that certain .596 acre parcel of land described in the Deed from Realty Syndicate Company, a corporation, to Edward T. Joste and Annie Joste, his wife, dated July 11th, 1919, and recorded in Liber 2801 of Deeds, at page 1, Alameda County Records; thence North 54 degrees, 06' 30" East 100 feet; thence North 35 degrees, 53' 30" West 53.30 feet; thence South 54 degrees, 06' 30" West 100 feet, more or less, to the Northeasterly line of Laurel Avenue, as said Laurel Avenue is described in the Deed from Realty Syndicate Company, a corporation, to the City of Oakland, a municipal corporation, dated March 19th, 1921, and recorded in Liber 3058 of Deeds, page 456; and thence Southeasterly on the arc of circle (having a radius of 462.16 feet) along said Laurel Avenue 50 feet, more or less, to the point of beginning.

Being a portion of that certain 267.46 acre piece or parcel of land firstly described in that certain Deed from John H. Spring and Celina D. Spring, his wife, and Charlotte B. Spring to the Realty Syndicate, a corporation, dated June 2nd, 1909, and recorded June 9th, 1909, in Liber 1610 of Deeds at page 123 in the office of the County Recorder of said County of Alameda, and

Being a portion of that certain 25.48 acre piece or parcel of land described in that certain Deed from George Sterling and Carrie R. Sterling, his wife, to the Realty Syndicate, a corporation, dated

May 26, 1903, and recorded August 18, 1903, in Liber 923 of Deeds at page 273 in the office of the County Recorder of said County of Alameda, State of California.

Parcel 10: Commencing at the intersection of the Northeasterly line of Wallace Street, with the Northwesterly line of 19th Avenue, as said Street and Avenue are shown on the Map hereinafter described; thence along the Northwesterly line of 19th Avenue North 36 degrees, 47' East, 39.10 feet to a point where said line is intersected by a line drawn parallel to and distant 100 feet at right angles Easterly from the West line of Lot 12 hereinafter described; thence North 24 degrees, 37' West parallel to and distant 100 feet at right angles from the Westerly line of Lot 12, 90 feet; thence South 65 degrees, 23' West 40 feet; thence South 24 degrees, 37' East, 96 feet, more or less, to the Northeast line of Wallace Street; thence along said line Southeasterly to the point of beginning.

Being a portion of Lot #12, as the said Lot is laid down and delineated upon that certain Map entitled "Map of Portion of Highland Park," etc., filed April 28th, 1879, in the office of the County Recorder of Alameda County.



EXHIBIT No. 10

60

Cochran & Celli

Annual Closing Balances in Investment Accounts Transcribed from General Ledger

	Dec. 31, 1937	Dec. 31, 1938	Dec. 31, 1939	Dec. 31, 1940	Dec. 31, 1941	Dec. 31, 1942	Dec. 31, 1943	Dec. 31, 1944
J. E. Cochran	\$91,842.88	\$87,023.86	\$89,722.86	\$98,782.86	\$106,822.45	\$95,908.80	\$84,446.97	\$73,549.43
Mabel Cochran	50,162.80	53,748.59	58,687.22	71,262.78	94,057.61	89,250.72	86,716.59	86,182.03
Sidney E. Cochran	33,636.42	36,048.52	39,221.81	47,283.10	54,531.48	63,584.03	75,943.88	89,919.96
Bernice C. Johnson	33,636.42	36,038.52	39,296.90	47,455.08	54,681.51	64,157.47	75,147.72	85,015.36
Winifred Irwin	—	—	—	—	54,296.14	63,251.62	74,809.58	90,787.76
Donald R. Cochran	—	—	—	—	25,923.26	53,084.86	74,225.25	86,949.04
Total Cochran Group	\$242,914.94	\$248,898.01	\$266,206.23	\$316,128.41	\$391,212.45	\$429,237.50	\$471,289.99	\$512,403.58
Bernardo Celli, Sr.	87,528.52	71,237.95	70,278.66	81,294.45	92,219.20	94,310.54	97,536.94	101,477.23
Anna Celli	53,972.84	47,916.17	52,443.25	64,289.80	82,772.23	95,305.88	107,994.67	121,250.80
Bernardo Celli, Jr.	48,052.04	61,561.47	67,127.54	81,836.21	103,388.15	110,842.36	122,176.59	133,909.40
Lloyd J. Celli	48,052.04	61,561.47	67,154.66	81,804.08	102,739.42	109,046.48	120,851.41	133,777.94
Total Celli Group	\$237,605.44	\$242,277.06	\$257,004.11	\$309,224.54	\$381,119.00	\$409,505.26	\$448,559.61	\$490,415.37
Total	\$480,520.38	\$491,175.07	\$523,210.34	\$625,352.95	\$772,331.45	\$838,742.76	\$919,849.60	\$1,002,818.95

EXHIBIT No. 11

Cochran & Celli

Statement of Partners' Earnings for Services Rendered
As Shown on Salary Accounts of Partnership

	1938	1939	1940	1941	1942	1943	1944
Bernardo Celli, Sr.	\$3600.00	\$3600.00	\$3600.00	\$4550.00	\$6712.50	\$4800.00	\$4800.00
J. E. Cochran	3600.00	3600.00	3600.00	4300.00	4800.00	4800.00	4800.00
B. Celli, Jr.	3900.00	3900.00	5200.00	6200.00	4200.00	4200.00	4200.00
Lloyd J. Celli	1200.00	1800.00	2100.00	4625.00	337.00	—	—
Sidney E. Cochran	2400.00	2700.00	4200.00	4600.00	3662.50	3900.00	—
Donald R. Cochran	—	—	61.20	95.00	2050.00	2937.50	3487.00

EXHIBIT No. 12

Summary of Annual Withdrawals Charged to Individual Accounts

These amounts are in addition to withdrawals for services rendered as shown in Exhibit 11 and transfers entered as gifts as shown in Exhibits 1 to 6.

Date	Bernardo Celli, Sr.	Anna Celli	Bernardo Celli, Jr.	Lloyd Celli	J. E. Cochran	Mabel Cochran	Sidney Cochran	Donald Cochran	Winifred Cochran Irwin	Bernice Cochran Johnson
1938— January thru December	\$12,684.60	None	None	None	\$11,383.14	None	None	None	None	None
1939— January thru December	7,681.31	None	\$ 241.39	\$ 214.27	5,294.27	None	\$1,627.42	None	\$71.79	\$52.33
1940— January thru December	4,845.37	None	444.72	503.97	7,515.57	None	226.50	None	220.64	129.61
1941— January thru December	12,427.08	None	1,959.84	2,576.44	11,655.24	None	599.92	admitted to partnership	896.75	621.87
1942— January thru December	15,668.14	\$5,225.83	10,305.26	11,452.41	12,673.13	\$7,466.36	3,827.19	1,718.14	3,924.26	3,495.29
1943— January thru December	19,066.81	9,544.42	10,898.98	10,428.28	15,469.75	6,542.05	5,369.40	6,588.86	6,831.29	6,739.00
1944— January thru December	18,122.43	8,506.59	10,329.91	9,136.19	14,782.70	4,419.72	6,144.06	7,396.35	4,141.96	10,252.50



EXHIBIT No. 13

Summary of Annual Withdrawals
from
Bernice Cochran Johnson Account

Year	For Income Taxes	Other than for Income Taxes	Total Withdrawals
1938	None	None	None
1939			
January thru December	\$ 52.33	None	\$ 52.33
1940			
January thru December	129.61	None	129.61
1941			
January thru December	621.87	\$4,000.00*	4,621.87*
1942			
January thru December	2,314.04	5,089.74*	7,403.78*
1943			
January thru December	5,429.58	3,809.42*	9,239.00*
1944			
January thru December	3,763.50	6,489.00	10,252.50

* Includes gift by check to Donald Robert Cochran as shown in Exhibit 4.

EXHIBIT No. 14

Summary of Annual Withdrawals
from
Winifred Cochran Irwin Account

Year	For Income Taxes	Other than for Income Taxes	Total Withdrawals
1938	None	None	None
1939			
January thru December	\$ 71.79	None	\$ 71.79
1940			
January thru December	220.64	None	220.64
1941			
January thru December	896.75	\$4,000.00*	4,896.75*
1942			
January thru December	2,890.96	5,033.30*	7,924.26*
1943			
January thru December	5,079.32	4,251.97*	9,331.29*
1944			
January thru December	3,020.86	1,121.10	4,141.96

* Includes gifts by check to Donald Robert Cochran as shown in Exhibit 5.

EXHIBIT No. 15

Cochran & Celli

Balance Sheet

December 31, 1938

(All Divisions Combined)

Current:		Assets	
Cash on Hand and in Bank.....			\$ 28,402.69
Contracts in Transit—Finance Companies..			12,169.44
Receivables:			
Notes Receivable	\$107,682.10		
Accounts Receivable	95,542.07		
Accounts Payable—Debit Balances	4,091.19		207,315.36
Inventories:			
New Cars and Freight and Handling	47,375.97		
Metro Bodies	12,550.61		
Used and Repossessed Cars	31,280.00		
Parts	31,796.32		
Accessories	6,295.41		
New Tires and Tubes	12,311.09		
Body and Trim Materials	39,695.79		
Paint Materials	1,303.83		
Gas, Oil and Grease	1,230.75		
Work in Process — labor	1,472.61		
Other Sundry Inventories	2,364.58		187,676.96
Securities			1,902.80
Prepaid Expenses:			
Taxes	2,136.12		
Insurance	1,904.37		
Advertising	569.00		
Sundry	284.14		4,893.63
Total Current Assets			\$442,360.88
Fixed Assets:			
Land	87,809.48		
Buildings	105,669.59		
Equipment	98,934.64		
Leasehold Improvements	2,375.78		294,789.49
Deferred Assets:			
Deposits on Contracts	929.00		
Repossession Reserves—Finance			
Companies	9,869.11		
Advances to Employees	3,210.16		
Sundry Investments, less depreciation	7,010.50		21,018.77
			<u>\$758,169.14</u>

Cochran & Celli

Balance Sheet

December 31, 1938

(All Divisions Combined)

Liabilities

Current:

Accounts Payable:

Trade Creditors	\$ 34,899.25	
Accounts Receivable—Credit Balances	22,079.29	
Finance Charges Collected	913.87	
Service Contract Deposits	111.94	\$ 58,004.35

Notes Payable:

New Cars Financed	12,029.90	
Anglo California National Bank— Unsecured	25,000.00	37,029.90

Accrued Liabilities:

Interest	15.36	
Payroll and Commissions	1,928.36	
Insurance	943.44	
Taxes	16,443.75	
Promotional Expense	225.00	19,555.91

Total Current Liabilities

\$114,590.16

Mortgages Payable

35,000.00

Reserves:

Bad Debts	6,797.54	
Depreciation of Buildings	46,683.53	
Depreciation of Equipment	57,408.89	
Amortization of Improvements	267.95	
Used and Repossessed Car Expenses	6,256.00	117,413.91

Net Worth

Investment — January 1, 1938	480,520.38
Net Profit for 1938	34,712.43

\$515,232.81

Withdrawals for 1938	24,067.74
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Investment — December 31, 1938	491,165.07
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\$758,169.14

EXHIBIT No. 16

Cochran & Celli

Balance Sheet

December 31, 1939

(All Divisions Combined)

Assets

Current:

Cash on Hand and in Bank		\$ 39,522.07
Contracts in Transit—Finance Companies..		14,572.18
Notes and Accounts Receivable:		
Notes Receivable	\$ 97,376.07	
Accounts Receivable	100,124.30	
Accounts Payable — debit balances	2,363.35	199,863.72

Inventories:

New Cars and Freight and Handling	49,780.60	
Metro Bodies	11,566.11	
Used and Repossessed Cars	36,489.16	
Parts	37,664.51	
Accessories	7,078.57	
New Tires and Tubes	7,943.02	
Used Tires and Tubes	994.10	
Body and Trim Materials	45,523.31	
Gas, Oil and Grease	1,099.63	
Work in Process — labor	3,273.70	
Other Sundry Inventories	2,309.24	203,721.95

Securities	289.00
Discount Receivable on Car Purchases	6,142.50

Prepaid Expenses:

Taxes	2,426.59	
Insurance	1,909.16	
Advertising	531.00	
Sundry	260.76	5,127.51

Total Current Assets	\$469,238.93
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Fixed Assets:

Land	93,066.40	
Buildings	120,324.35	
Improvements	3,089.47	
Equipment	108,493.44	324,973.66

Deferred Assets:

Deposits on Contracts	854.00	
Repossession Reserves—finance companies....	17,622.46	
Advances to Employees	2,335.69	
Sundry Investments—less depreciation	13,200.91	34,013.06

	\$828,225.65
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Cochran & Celli

Balance Sheet

December 31, 1939

(All Divisions Combined)

Liabilities

Current:

Accounts Payable:

Trade Creditors	\$ 29,708.37	
Accounts Receivable—credit balances	28,998.33	
Finance Charges Collected	746.96	
Service Contract Deposits	2,733.29	\$ 62,186.95

Notes Payable:

New Cars Financed	39,935.55	
Anglo Calif. National Bank—Unsecured..	18,000.00	57,935.55

Accrued Liabilities:

Interest	22.99	
Payroll	196.06	
Insurance	2,036.27	

Taxes	17,682.10	
Promotional Expense	250.00	20,187.42

Total Current Liabilities

\$140,309.92

Mortgage Payable

35,000.00

Reserves:

Bad Debts	6,870.00	
Depreciation of Buildings	50,719.28	
Depreciation of Improvements	446.75	
Depreciation of Equipment	64,371.53	
Used and Repossessed Car Expenses	7,297.83	129,705.39

Net Worth

Investment — January 1, 1939	491,165.07
Net Profit for 1939	45,728.05

\$536,893.12

Withdrawals for 1939	13,682.78
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Investment — December 31, 1939	\$523,210.34
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\$828,225.65

EXHIBIT No. 17

Cochran & Celli

Balance Sheet

December 31, 1940

(All Divisions Combined)

Current:		Assets	
Cash on Hand and in Bank			\$ 20,913.96
Contracts in Transit—finance companies..			27,399.92
Notes and Accounts Receivable:			
Notes Receivable	\$120,461.83		
Accounts Receivable	135,424.81		
Accounts Payable—debit balances	2,362.26		258,248.90
			<hr/>
Inventories:			
New Cars and Freight and Handling	57,024.19		
Special Bodies and Cabs	8,790.67		
Used and Repossessed Cars	51,276.78		
Parts	45,565.96		
Accessories	11,386.11		
New Tires and Tubes	15,986.49		
Recapped Tires	1,389.03		
Body and Trim Materials	47,571.89		
Gas, Oil and Grease	697.01		
Work in Process — Labor	3,279.70		
Other Sundry Inventories	2,370.14		245,337.97
			<hr/>
Securities			457.00
Discount Receivable on Car Purchases			9,292.50
Prepaid Expenses:			
Taxes	2,635.53		
Insurance	3,228.50		
Advertising	474.00		6,338.03
			<hr/>
Total Current Assets			\$567,988.28
Fixed Assets:			
Land	93,066.40		
Buildings	120,324.35		
Improvements	3,574.61		
Equipment	113,247.12		330,212.48
			<hr/>
Deferred Assets:			
Deposits on Contracts	944.00		
Repossession Reserves—Finance companies..	33,997.55		
Advances to Employees	2,429.13		
Sundry Investments—less depreciation	13,486.82		50,857.50
			<hr/>
			\$949,058.26
			<hr/>

Cochran & Celli

Balance Sheet
December 31, 1940

(All Divisions Combined)

Liabilities

Current:

Accounts Payable:

Trade Creditors	\$ 45,141.65	
Due on Repossessed Cars	1,986.00	
Accounts Receivable—credit balances	26,258.54	
Finance Charges Collected	3,244.54	
Service Contract Deposits	7,641.50	\$ 84,272.23

Notes Payable:

New Cars Financed	46,602.38	
Anglo Calif. National Bank—Unsecured..	14,000.00	
Others	8,385.33	68,987.71

Accrued Liabilities:

Interest	186.38	
Payroll	1,920.44	
Commissions	2,333.41	
Insurance	1,225.81	
Taxes	22,463.24	
Promotional Expense	555.00	28,684.28

Total Current Liabilities		\$181,944.22
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Reserves:

Bad Debts	6,783.67	
Depreciation of Buildings	55,055.39	
Depreciation of Improvements	1,009.00	
Depreciation of Equipment	68,657.67	
Used and Repossessed Car Expenses	10,255.36	141,761.09

Net Worth

Investment — January 1, 1940	523,210.34	
Net Profit for 1940	116,028.99	
	\$639,239.33	
Withdrawals for 1940	13,886.38	
Investment — December 31, 1940		625,352.95
		<u>\$949,058.26</u>

EXHIBIT No. 18

Cochran & Celli

Balance Sheet

December 31, 1941

(All Divisions Combined)

Current:	Assets	
Cash on Hand and in Bank		\$ 28,160.28
Contracts in Transit—G.M.A.C.....		5,236.98
Notes and Accounts Receivable:		
Notes Receivable	\$124,955.33	
Accounts Receivable	144,314.92	
Accounts Payable—debit balances	458.28	269,728.63
Inventories:		
New Cars and Freight and Handling	159,907.07	
Special Bodies and Cabs	12,793.22	
Used and Repossessed Cars	21,018.34	
Parts	71,627.26	
Accessories	10,561.58	
New Tires and Tubes	22,692.94	
Recapped Tires and Tire Repair		
Material	10,448.77	
Body and Trim Materials	42,396.76	
Gas, Oil and Grease	978.80	
Work in Process — Labor	3,313.21	
Other Sundry Inventories	3,589.29	359,327.24
Securities		457.00
Discount Receivable on New Car Purchases..		7,612.50
Prepaid Expenses:		
Taxes	2,722.12	
Insurance	2,956.93	
Advertising	1,176.00	6,855.05
Total Current Assets		\$677,377.68
Fixed Assets:		
Land	108,535.16	
Buildings	153,927.21	
Improvements	3,826.17	
Equipment	88,677.70	354,966.24
Deferred Assets:		
Deposits on Contracts	1,154.00	
Repossession Reserves—finance companies...	45,452.38	
Advances to Employees	1,383.52	
Miscellaneous Real Estate	2,191.55	50,181.45
		\$1,082,525.37

Cochran & Celli

Balance Sheet

December 31, 1941

(All Divisions Combined)

Liabilities

Current:

Accounts Payable:

Trade Creditors	\$ 64,665.46	
Accounts Receivable—credit balances	18,170.32	
Finance Charges Collected	418.15	
Service Contract Deposits	11,252.59	\$ 94,506.52

Notes Payable:

New Cars Financed	63,026.29	
Others	19,698.04	82,724.33

Accrued Liabilities:

Interest	322.75	
Payroll	5,466.70	
Commissions	1,175.45	
Insurance	1,630.16	
Taxes	17,453.28	
Promotional Expense	310.00	26,358.34

Total Current Liabilities		\$ 203,589.19
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Reserves:

Bad Debts	6,134.42	
Depreciation of Buildings	59,670.82	
Depreciation of Improvements	1,484.18	
Depreciation of Equipment	35,111.64	
Used and Repossessed Car Expense	4,203.67	106,604.73

Net Worth

Investment — January 1, 1941	625,352.95	
Net Profit for 1941	177,715.64	
	\$803,068.59	
Withdrawals for 1941	30,737.14	
Investment — December 31, 1941		772,331.45
		<u>\$1,082,525.37</u>

EXHIBIT No. 19

Cochran & Celli

Balance Sheet

December 31, 1942

(All Divisions Combined)

Current:		Assets	
Cash on Hand and in Bank			\$ 172,517.48
Contracts in Transit			723.85
Notes and Accounts Receivable:			
Notes Receivable	\$ 64,420.90		
Accounts Receivable	104,249.62		
Accounts Payable—debit balances	232.48		168,903.00
Inventories:			
New Cars and Freight and Handling	163,169.27		
Special Bodies and Cabs	17,716.37		
Used and Repossessed Cars	15,484.73		
Parts	89,685.77		
Accessories	7,584.70		
New Tires and Tubes	11,662.31		
Recapped Tires and Tire Repair			
Material	1,346.52		
Body and Trim Materials	44,934.36		
Gas, Oil and Grease	746.05		
Work in Process — Labor	2,524.93		
Other Sundry Inventories	3,732.51		358,587.52
Securities			457.00
Prepaid Expenses:			
Taxes	2,879.19		
Insurance	3,351.67		
Advertising	1,122.00		7,352.86
Total Current Assets			\$708,541.71
Fixed Assets:			
Land	108,535.16		
Building	156,767.51		
Improvements	3,826.17		
Equipment	90,646.83		359,775.67
Deferred Assets:			
Deposits on Contracts	1,184.00		
Repossession Reserves	26,526.84		
Advances to Employees	1,016.23		
Miscellaneous Real Estate	2,191.55		30,918.62
			<u>\$1,099,236.00</u>

Cochran & Celli
Balance Sheet
December 31, 1942
(All Divisions Combined)

Liabilities

Current:

Accounts Payable:

Trade Creditors	\$ 37,616.49	
Accounts Receivable—credit balances	16,876.76	
Service Contract Deposits	8,263.47	\$ 62,756.72

Notes Payable:

New Cars Financed	61,990.04	
Others	5,226.16	67,216.20

Accrued Liabilities:

Interest	2,126.11	
Payroll	13.75	
Insurance	1,195.30	
Taxes	8,185.22	11,520.38

Total Current Liabilities		\$ 141,493.30
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Reserves:

Bad Debts	4,016.89	
Depreciation of Buildings	65,486.66	
Depreciation of Improvements	2,355.74	
Depreciation of Equipment	44,043.70	
Used and Repossessed Car Expense	3,096.95	118,999.94

Net Worth

Investment — January 1, 1942	772,331.45	
Net Profit for 1942	142,075.81	
	\$914,407.26	
Withdrawals for 1942	75,664.50	
Investment — December 31, 1942		838,742.76
		<u>\$1,099,236.00</u>

EXHIBIT No. 20

Cochran & Celli

Balance Sheet

December 31, 1943

(All Divisions Combined)

Assets

Current:

Cash on Hand and in Bank \$ 195,002.18

Notes and Accounts Receivable:

Notes Receivable	\$ 25,069.59	
Accounts Receivable	74,385.95	
Accounts Payable—debit balances	122.49	99,578.03

Inventories:

New Cars and Freight Handling	59,923.28	
Special Bodies and Cabs	7,731.89	
Used Cars	37,509.51	
Parts	75,405.99	
Accessories	7,500.93	
New Tires and Tubes	14,325.34	
Body Materials	35,326.20	
Recapping Material	2,034.89	
Duco Materials	5,892.19	
Gas, Oil and Grease	686.95	
Work in Process	3,488.93	
Other Sundry Inventories	1,120.99	250,947.09

Securities 457.00

Prepaid Expenses:

Taxes	2,882.67	
Insurance	6,134.01	
Advertising	384.00	9,400.68

Total Current Assets 555,384.98

Fixed Assets:

Land	232,146.95	
Buildings	239,175.37	
Improvements	3,826.17	
Equipment	105,838.22	580,986.71

Deferred Assets:

Deposits on Contracts	729.00	
Repossession Reserves	1,225.87	
Advances to Employees	923.87	
Miscellaneous Real Estate	2,191.55	5,070.29

\$1,141,441.98

Cochran & Celli

Balance Sheet

December 31, 1943

(All Divisions Combined)

Liabilities

Current:

Accounts Payable:

Trade Creditors	\$ 42,527.96	
Accounts Receivable—credit balances	20,328.53	
Service Contract Deposits	7,739.59	\$ 70,596.08

Accrued Liabilities:

Insurance	1,941.58	
Taxes	8,646.61	10,588.19

Total Current Liabilities		<u>\$81,184.27</u>
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Reserves:

Bad Debts	3,112.40	
Depreciation of Buildings	71,581.63	
Depreciation of Improvements	2,672.93	
Depreciation of Equipment	55,539.25	
Used Car Expenses	7,501.90	140,408.11

Net Worth

Investment — January 1, 1943	838,742.76
Net Profit for 1943	177,865.68

\$1,016,608.44

Withdrawals for 1943	96,758.84
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Investment — December 31, 1943	<u>919,849.60</u>
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\$1,141,441.98

EXHIBIT No. 21

Cochran & Celli

Balance Sheet

December 31, 1944

(All Divisions Combined)

Current:		Assets	
Cash on Hand and in Bank			\$ 205,880.69
Notes and Accounts Receivable:			
Notes Receivable	\$ 30,844.73		
Accounts Receivable	100,742.51		
Accounts Payable—debit balances	73.30		
Interest Receivable	200.48		131,861.02
Inventories:			
New Cars and Freight and Handling	7,360.90		
Special Bodies and Cabs	694.14		
Used Cars	64,959.33		
Parts	99,243.82		
Accessories	4,320.45		
New Tires and Tubes	8,299.63		
Body Materials	76,034.32		
Recapping Material	3,964.67		
Duco Materials	5,566.14		
Gas, Oil and Grease	1,106.26		
Work in Process	6,649.90		
Other Sundry Inventories	637.08		278,836.64
Securities			55,457.00
Prepaid Expenses:			
Taxes	5,992.26		
Insurance	4,756.14		
Advertising	36.00		10,784.40
Total Current Assets			\$682,819.75
Fixed Assets:			
Land	232,146.95		
Buildings	239,175.37		
Improvements	3,826.17		
Equipment	102,450.89		577,599.38
Deferred Assets:			
Deposits	346.62		
Repossession Reserves	386.04		
Advances to Employees	1,437.56		
Miscellaneous Real Estate	2,191.55		4,361.77
			<u>\$1,264,780.90</u>

Cochran & Celli

Balance Sheet

December 31, 1944

(All Divisions Combined)

Liabilities

Current:

Accounts Payable:		
Trade Creditors	\$ 62,763.51	
Accounts Receivable—credit balances.....	15,344.53	
Service Contract Deposits	7,355.17	\$85,463.21
<hr/>		
Accrued Liabilities:		
Payroll	1,398.16	
Insurance	2,435.38	
Taxes	9,390.28	13,223.82
<hr/>		
Total Current Liabilities		\$98,687.03

Reserves:

Bad Debts	2,730.98	
Depreciation of Buildings	80,423.52	
Depreciation of Improvements	2,939.69	
Depreciation of Equipment	63,566.12	
Used Car Expenses	13,614.61	163,274.92
<hr/>		

Net Worth

Investment — January 1, 1944	919,849.60	
Net Profit for 1944	176,501.76	
<hr/>		
Withdrawals for 1944	93,532.41	\$1,096,351.36
Investment — December 31, 1944		1,002,818.95
<hr/>		
<u>\$1,264,780.90</u>		

EXHIBIT No. 22

Schedule of Annual Net Profits of Cochran & Celli
for the Years 1932 to 1944, Inclusive

1932	..... (Loss) \$ 19,587.90
1933	..... 25,343.66
1934	..... 15,216.96
1935	..... 46,462.47
1936	..... 65,699.40
1937	..... 72,680.54
1938	..... 49,406.81
1939	..... 65,742.01
1940	..... 135,892.66
1941	..... 202,841.39
1942	..... 160,720.11
1943	..... 198,238.69
1944	..... 187,354.46

Filed at hearing May 11, 1950.

The Tax Court of the United States

Docket No. 26266

ESTATE OF MABEL COCHRAN, Deceased,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 26267

JOSEPH E. COCHRAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Courtroom 421, Appraisers Building,

San Francisco, California, Thursday, May 11, 1950.

PROCEEDINGS

(Met, pursuant to notice, at 10:00 o'clock a. m.)

Before: Hon. Samuel B. Hill, Judge.

Appearances:

ELI FREED, ESQ., and

EMMETT GEBAUER, ESQ.,

1069 Mills Building,

San Francisco 4, California,

Appearing on Behalf of Petitioner.

CHARLES W. NYQUIST, ESQ.,

(Hon. Charles Oliphant, Chief Counsel,
Bureau of Internal Revenue)

Appearing for the Respondent.

The Court: Call the case for trial.

The Clerk: Docket 26266, Estate of Mabel Cochran, 26267, Joseph E. Cochran.

The Court: Announce your appearances, please.

Mr. Freed: Eli Freed—I am Eli Freed. This is Emmett Gebauer, Counsel for the Petitioner.

Mr. Nyquist: Charles W. Nyquist for Respondent.

The Court: State your case for the Petitioner. These cases are being consolidated for hearing, I take it.

Mr. Freed: Yes, your Honor.

The Court: They may be consolidated for hearing.

Mr. Freed: This case, your Honor, as you know, involves the years 1942, 1943 and 1944 and concerns a business in Oakland, Alameda County, California. It is what might be classed as a family partnership income tax case. This business is an old business, a Chevrolet dealership, automobile dealership, with a number of departments. I think it is the oldest Chevrolet dealership in California. The business was originally organized, I think, back in 1906 by Mr. Joseph E. Cochran and Bernardo Celli, Sr. They were partners and they did business under the name of Cochran and Celli. Mr. Cochran was

married to Mabel Cochran, who had died in 1946. Bernardo Celli was married to Anna Celli, and they have both died. Bernardo Celli, Sr., died in August of 1945 and Anna Celli died [3*] in the spring of 1947. The property of the partnership as between the husband and wife was community property under the laws of California. On the Cochran side there were four children—there are four children—and I might add that the families are unrelated to each other by blood or marriage. Now, on the Cochran side there are four children, Sidney E. Cochran, Donald Robert Cochran, the two boys, and Bernice Cochran Johnson, now married—her married name is Johnson—and Winifred Cochran Irwin married James Irwin. All of these children are adults, now adults.

Now, on the Celli side there were two children. There is Bernardo Celli, Jr., called Ben Celli, and reference will no doubt also be made to the senior Bernardo Celli who is also known as Ben Celli, Sr. There is another son, Lloyd Celli. They are adults.

In 1937, the senior members of the families initiated steps which led to the formation of a partnership by all of the members of both families, taking effect January 1, 1938, and the partnership which is before the court is that partnership, which was organized on January 1, 1938. At that time all of the children were adults with the exception of Donald Robert Cochran, who was then seventeen years of age, and he was not admitted to partner-

* Page numbering appearing at top of page of original Reporter's Transcript of Record.

ship at that time. A written partnership agreement, very comprehensive agreement, was drafted by the lawyer representing all of the parties, a Mr. Leo Wilson, [4] and that partnership agreement, which will be offered in evidence—it has been stipulated to, by the way—recognizes that Donald Robert Cochran was not yet twenty-one years of age and contemplates that he would, if he desired, be admitted as a partner when he became twenty-one years of age.

This partnership of Cochran and Celli, in 1937, had a substantial amount of capital in the business and our case will, of course, be to that extent—the capital was of extreme importance in this business and that it was a very important factor in the production—for doing business and the production of income. The boys, with the exception of Donald, in 1937 were working in the business and were exercising important functions in the business. At this juncture I should perhaps observe that the boys—they are no longer boys, they are men, if your Honor please—but the sons, as far as the sons are concerned, their status is not being questioned by the respondent, nor, for that matter—to what extent the status of the girls is being questioned is not exactly clear, but what is being questioned, and I put it this way advisedly, is the taxability of the income attributed to the daughters in this partnership for the years before the court. That is, the taxability of their distributive shares in the partnership to them, and it is contended by respondent that the income attributed to the daugh-

ters, that is the income from the partnership to which they are entitled to for those years, should be [5] taxed to J. Cochran and Mabel Cochran, their father and mother.

The Court: On the basis of community interest or a partnership between the husband and wife?

Mr. Freed: That isn't clear from the deficiency letter. The deficiency letter merely states that one-half of the income of the daughters will therefore be taxed to J. Cochran, and the letter sent to him and the letter to Mabel—not to Mabel Cochran but the estate of Mabel Cochran, deceased—they are similarly addressed and state the same thing.

The parents and the children decided, as I said, to form the partnership, and then a lawyer was engaged and the lawyer advised them to establish investment accounts or transfer capital to the children from the parents through gifts, and that it would be to the advantage of the parents to make their initial transfer of gifts to the children in a manner that would result in no gift tax, in the year in which the partnership was organized and thereafter, to build up the interests of the children by gifts of amounts which would be excluded, that is, exclusionary amounts from the gift tax thereafter for some years until the plan which they had would be permanently established. However, this is not a gift tax case, it is an income tax case, and there was no income tax motive whatsoever which induced the parents or the children to form the partnership. The reason for the partnership, the [6] purpose for it, is a purpose which is entirely consistent with

the situation then existing and consistent with the philosophy of the families. The boys were then working in the business. In fact, Ben Celli, Jr., had a very important position in the business; Sidney Cochran had a very important position in the business at that time; Lloyd Celli was doing important work at that time as well.

The Court: Do we have in this case a question of whether or not the Celli children were partners?

Mr. Freed: They are recognized as partners, your Honor.

The Court: We do not have to decide that in this case?

Mr. Freed: No, we don't, but the entire picture, as we see it, will have to be presented to the court in order to ascertain the intent of the parties. We do not have here the conventional case, as I see it, of husband and wife or of one family or of children being brought into a business of a certain kind and where you have more or less the usual pattern or form. We have a different case; we have a case of an old, established partnership here, and there are many members of the partnership on both sides, and at a time when income was not very high and income tax rates were comparatively low. In fact, some years before there were any increases in income tax rates, and no question was ever made by the respondent of the bona fide status of this partnership officially until a 30-day letter was sent, that is, a 30-day protest letter, with [7] findings of the Office of Internal Revenue Agent in Charge, San Francisco office, in October of 1948, and the

first years ever questioned were these years, 1942, 1943, and 1944, and the 30-day letter refers to the Tower and Lusthaus cases.

Now, it will be the position of the petitioners that bona fide, completed, honest, true gifts were made to the daughters and that the conduct of the parties, pursuant to the partnership agreement and with respect to each other and in the business was entirely consistent and supports the position of the petitioner that the gifts were in every sense complete, recognized, and that these were gifts of investments; the investments were true investments, the investments were productive of income, and that the income earned by those investments belonging to the daughters should be taxed to the daughters.

I should mention that those partners who worked in the business, that is, the two fathers, J. Cochran and Bernardo Celli, Sr., and Sidney Cochran and Donald Cochran and Bernardo Celli, Jr., and Lloyd Celli, all earned salaries. The salaries were paid to them for their services consistently and at all times in recognition of their services. That is, that factor or element in the partnership was treated in a very realistic manner right from the very beginning, and that factor, in so far as it was income producing, was recognized by—as earning income to those persons as compensation for the services which [8] they rendered.

There is another element in this partnership which is of significance, which I think should also be given, or should be observed at this time. The

business, as I suggested before, consisted of a number of departments. There was the new car department and the used car department, and a body-building department. That has always been an important department in the business—tire department, finance department, and the partnership owned a considerable amount of real property used in the business. They owned their own improved real property, which is a very substantial part of the assets of this business.

When the partnership was formed in 1937 it was recognized, in view of the fact there were a considerable number of partners in this enterprise, that it would be efficient and desirable to vest the real property in trust with the two oldest sons. That is, in trust for all of the partners, and the real property was vested in them that way and the partnership agreement so provides, and the two oldest sons signed a declaration of trust to that effect. The partnership agreement also recognized the difference in number of members of the families on each side. On the Cochran side when the partnership was organized, your Honor, there were five members in the partnership, and on the Celli side there were four members of the partnership, and the history of this business has always [9] been that the control or voice in the business be equally divided between the two families and that profits and losses, of course, also be divided equally.

Upon the formation of this partnership it was recognized that in order to maintain that equality of voice in the business and for good—other good

business reasons, which will be brought out, we trust, the two parents were designated as managers, and the agreement by its terms vests in those two parents as managers an equality of control which could, if necessary, be exercised to the extreme. However, that maintained the equality of voice in the two families. Now, after the partnership was organized and for several years thereafter, consistent with the policy of the business for many years, the partners continued to build up their investment accounts for purposes of expansion, which will be brought out, I feel certain, and there were very few—there will be a schedule of the drawings of the partners presented here—and the business was built up over the years and their investment accounts grew. Those partners who worked drew salaries; those who didn't work didn't get any salaries, and finally—that is, before notice was ever received from the government—objectively and for good and valid business reasons this business was reorganized on July 1, 1948. I might mention an amendment amending the partnership agreement was made in February, 1945, which will also be offered in evidence. Only July 1, 1948, the Cochran and [10] Celli automobile dealership was reorganized and a corporation was formed and all of the property of the business with the exception of the real property—pertaining to the operation of that automobile dealership and its departments, were all transferred to the corporation, subject to the obligations of the business, and stock was issued, capital stock. The corporation was and is a Cali-

fornia corporation. Stock was issued to each and every one of the partners in consideration for the share of net worth attributable to each partner, which was transferred to the corporation, and stock was given to Mrs. Johnson—that is, Bernice Cochran—and to Winifred Cochran—that is, Winifred Irwin. That is, stock was given to them without any question at the time. There was no thought of any question, and the business has been operating as a corporation since July, 1948. However, with the real property, which was very substantial, it was kept in the partnership and the finance department was also kept in the partnership, and the name of the partnership was changed to Cochran and Celli Investment Company and the partners, Cochran and Celli, have been the partners of Cochran and Celli Investment Company—which of course occurred in 1948 but is of considerable importance as evidence of gifts that were made. They were always regarded as good, valid, completed gifts, and the parties carried through all the way down the line.

I think I should just mention, although it will come out, [11] it was in 1941 Donald Robert Cochran became an adult and at that time he was admitted to the partnership, and he has worked in the business ever since as an important executive in the business, has been for some time and is today.

The Court: Does that complete your statement?

Mr. Freed: Yes. If counsel wishes, I can offer stipulations——

The Court: Let Mr. Nyquist make his statement.

Mr. Freed: All right.

Mr. Nyquist: The partnership with which we are concerned here was formed in 1937 when the two senior members of the two families decided to bring in the members of their respective families, bring under the terms of the agreement—bring eight new members into the partnership. Respondent has recognized the sons who came in as partners. They were in the business, rendering valuable services. The wives need not be considered, for the reason the partnership interests originally were community property and whether or not the wives be recognized as partners, one-half of what would otherwise be the husband's income would be taxable to the wives under community property principles; so we are concerned only with the status of the two daughters, both in the Cochran family, and the years before the court are the years 1943 and 1944, and that carries with it the forgiveness year of 1942. Respondent will take the position that some of the things which Mr. Freed mentioned with respect to forming a corporation some ten years after the formation of [12] the original partnership, and when circumstances were greatly changed after the death of Mr. Celli and his wife and after the death of Mr. Cochran's wife—that circumstances were changed to such a great extent and that it was so far removed in time that such matters are entirely immaterial in this case. The parties have stipulated facts to the greatest extent possible. That is, we have stipulated practically all of the documentary material, I believe, and we have

stipulated book entries for the purpose of saving time in court in digging the material out of the books. We have not attempted to stipulate anything that might go into matters of opinion or intention of the parties.

I don't think I can say anything that will be of further help to the court at this time.

The Court: You may offer your stipulation of facts.

Mr. Freed: I now offer the stipulation arrived at by the parties.

The Court: The stipulation will be received.

Mr. Freed: And we ask permission—there is a copy here and there is an additional copy without exhibits which we will give to the clerk at noon, if your Honor please.

We also would like to offer at this time the partnership returns as exhibits next in order for the years 1942, 1943 and 1944.

The Court: Offer them one at a time. [13]

Mr. Freed: Yes. I offer first the partnership return of income for the calendar year 1942.

The Court: What is the exhibit number?

Mr. Nyquist: That will be 23, your Honor.

The Court: Admitted as Petitioner's Exhibit 23.

(Whereupon the document was marked for identification as Petitioner's Exhibit 23 and was received.)

Mr. Freed: I next offer as Petitioner's Exhibit No. 24 the partnership return of income of Cochran and Celli for the calendar year 1943.

The Court: Admitted.

(Whereupon the document was marked for identification as Petitioner's Exhibit 24 and was received.)

Mr. Freed: I next offer as Petitioner's Exhibit No. 25 the partnership return of income of Cochran and Celli for the calendar year 1944.

The Court: Admitted.

(Whereupon the document was marked for identification as Petitioner's Exhibit 25 and was received.)

Mr. Freed: I now wish to offer as Petitioner's Exhibit No. 26 a photostatic certified copy of a certificate of doing business under a fictitious name, filed in the office of the Clerk of Alameda County, June 29, 1938, pursuant to the provisions, I believe, of Sections 2466 and 2468 of the Civil Code of the State of California. [14]

Mr. Nyquist: No objection.

The Court: Admitted.

(Whereupon the document was marked for identification as Petitioner's Exhibit 26 and was received.)

PETITIONER'S EXHIBIT No. 26

Certificate of Doing Business Under a Fictitious Name

We, the undersigned, do hereby certify that we are transacting business as a copartnership in the State of California, and have our principal place

of business in the City of Oakland, County of Alameda, State of California, under the firm name and style of Cochran & Celli, and that we are the sole owners of said business.

That on the 7th day of August, 1923, a certificate of doing business under the said name of Cochran & Celli was filed and published in the County of Alameda in the manner required by law, and that since said time there has been a change in the personnel of the partnership transacting business under the said name, and that the undersigned are now the only persons having any interest in said business;

That our respective names and places of residence are as follows, to wit:

Joseph E. Cochran, 8 Aztec Way, Oakland, California.

Mabel Cochran, 8 Aztec Way, Oakland, California.

Winifred Cochran, 8 Aztec Way, Oakland, California.

Sidney Elmer Cochran, 2927 76th Avenue, Oakland, California.

Bernice Cochran Johnson, formerly Bernice M. Cochran, Coalinga, California.

Bernardo Celli, Sr., 1801 Melvin Road, Oakland, California.

Anna Celli, 1801 Melvin Road, Oakland, California.

Bernardo Celli, Jr., 2208 Carroll Street, Oakland, California.

Lloyd Celli, 1801 Melvin Road, Oakland, California.

That we are transacting a business in the buying, selling, manufacturing and repairing of new and used automobiles, parts, automotive vehicles and equipment.

Witness our hands this 20th day of May, 1938.

/s/ JOSEPH E. COCHRAN,

/s/ MABEL COCHRAN,

/s/ WINIFRED COCHRAN,

/s/ SIDNEY ELMER COCHRAN,

/s/ BERNICE COCHRAN

JOHNSON,

Formerely Bernice M.

Cochran;

/s/ BERNARDO CELLI, SR.,

/s/ ANNA CELLI,

/s/ BERNARDO CELLI, JR.,

/s/ LLOYD CELLI.

The foregoing instrument is a correct copy of the original on file in this office.

Attest: May 5, 1950.

G. E. WADE,

County Clerk and Ex-Officio Clerk of the Superior Court of the State of California in and for the County of Alameda.

By /s/ G. DeMARIA,

Deputy.

State of California,
County of Alameda—ss.

On this 20th day of May, in the year One Thousand Nine Hundred and Thirty-Eight, before me, Wm. S. Wells, Jr., a Notary Public in and for the County of Alameda, State of California, residing therein, duly commissioned and sworn, personally appeared Joseph E. Cochran, Mabel Cochran, Winifred Cochran, Sidney Elmer Cochran, Bernice Cochran Johnson, formerly Bernice M. Cochran; Bernardo Celli, Sr., Anna Celli, Bernardo Celli, Jr., and Lloyd Celli, known to me to be the persons described in and whose names are subscribed to the within instrument, and they acknowledged to me that they executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my Official Seal, the day and year in this certificate first above written.

[Seal] /s/ WM. S. WELLS,
Notary Public in and for said County of Alameda,
State of California.

[Endorsed]: Filed June 29, 1938.

Admitted in evidence May 11, 1950.

Mr. Freed: I now wish to offer in evidence for the sole purpose of establishing the element of time the letters dated October 5, 1948, sent by the office of the Internal Revenue Agent in Charge of the Treasury Department in San Francisco to J. E.

Cochran, Mabel Cochran, Bernice C. Johnson and Winifred Irwin, purely for the purpose of establishing the time of the notice of the proposed deficiency.

Mr. Nyquist: Objection, your Honor. These Revenue Agent's reports and letters are immaterial and add nothing to—contribute nothing toward determination of the sole question in issue in this case, whether these two daughters are members of the partnership.

The Court: I do not see the materiality of that.

Mr. Freed: The materiality is merely the element of time, that anything the parties did prior to the notice, or, that is, within a reasonable time prior to the notice, would, of course, have some weight from the standpoint of objectivity.

The Court: The notice of deficiency bears the date of issuance, does it not?

Mr. Freed: Yes.

The Court: That is the date that is important here, I [15] think.

Mr. Freed: That is all that I wish to establish.

The Court: I will sustain the objection.

Mr. Freed: All right.

The Court: I take it that the notice of deficiency is attached to your petition?

Mr. Freed: The notice of deficiency—that is correct. This notice that I have reference to, that I have offered for the dates, was merely the first notice received from the Treasury Department.

The Court: The date of the notice of deficiency is the determinative date.

Mr. Freed: Very well, your Honor.

I will call my first witness now.

The Court: Call your witness.

Mr. Freed: Mr. Joseph E. Cochran, please.

Whereupon,

JOSEPH E. COCHRAN

was called as a witness on behalf of the Petitioner, and having been first duly sworn, testified as follows:

The Clerk: State your name and address, please.

The Witness: J. E. Cochran.

The Court: What is your address?

The Witness: 108 Van Ripper Lane, Orinda, California. [16] ..

Direct Examination

By Mr. Freed:

Q. Mr. Cochran, in the year 1937 you were married to Mabel Cochran, is that correct?

A. Yes, sir.

Q. When were you married to her; when did you marry her? A. In 1908.

Q. Now, you were a partner—that is, prior to 1938—in the firm of Cochran and Celli, that is correct, is it not? A. Yes, sir.

Q. And your partner was Bernardo Celli, Sr.?

A. Yes, sir.

Q. How did that business originate?

A. It started as a blacksmith shop, known as the City Front Wagon Works.

Q. The City Front Wagon Works?

(Testimony of Joseph E. Cochran.)

A. Yes.

Q. And when was that business organized?

A. Well, that business was really organized in 1906.

Q. And who organized that business?

A. I started the business and my partner came in as a workman at that time.

Q. Who was your partner?

A. Later, but not in 1906.

Q. And you refer to Bernardo Celli, Sr.?

A. Yes. [17]

Q. Do you remember when you both became partners for the first time?

A. Well, we had a working partnership from the start, but we didn't take out any partnership papers for a number of years. I think 1911. I can't be quite sure but I believe that is right, and I think we took them out under the Cochran and Celli rather than under the City Front Wagon Works.

Q. You and Bernardo Celli, Sr., commenced a business under the name of Cochran and Celli, under a franchise or selling agreement from the Chevrolet Motor Company many years ago?

A. That's right.

Q. Do you remember when it was that you and Mr. Celli, Sr., first went into business together, formed a partnership together, in the operation of the Chevrolet automobile dealership?

A. Well, I can't say we were in partnership, we took what is known as a subdealership in 1915. We got our first franchise from Chevrolet Motor Com-

Mr. Freed: Very well, your Honor.

I will call my first witness now.

The Court: Call your witness.

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A. It started as a blacksmith shop, known as the City Front Wagon Works.

Q. The City Front Wagon Works?

(Testimony of Joseph E. Cochran.)

A. Yes.

Q. And when was that business organized?

A. Well, that business was really organized in 1906.

Q. And who organized that business?

A. I started the business and my partner came in as a workman at that time.

Q. Who was your partner?

A. Later, but not in 1906.

Q. And you refer to Bernardo Celli, Sr.?

A. Yes. [17]

Q. Do you remember when you both became partners for the first time?

A. Well, we had a working partnership from the start, but we didn't take out any partnership papers for a number of years. I think 1911. I can't be quite sure but I believe that is right, and I think we took them out under the Cochran and Celli rather than under the City Front Wagon Works.

Q. You and Bernardo Celli, Sr., commenced a business under the name of Cochran and Celli, under a franchise or selling agreement from the Chevrolet Motor Company many years ago?

A. That's right.

Q. Do you remember when it was that you and Mr. Celli, Sr., first went into business together, formed a partnership together, in the operation of the Chevrolet automobile dealership?

A. Well, I can't say we were in partnership, we took what is known as a subdealership in 1915. We got our first franchise from Chevrolet Motor Com-

(Testimony of Joseph E. Cochran.)

pany in 1917, in the spring. That is the first contract we had with the company that was under the name of Cochran and Celli.

Q. Yes, and prior to that time, that is 1912 to 1915, what was the nature of the business of Cochran and Celli?

A. Building wagons and heavy duty trucks, and making repairs.

Q. And after you were married you had four children, is [18] that right? A. Yes.

Q. There were Sidney Elmer Cochran, a son—suppose you state their names in the order of their ages. A. Bernice was our first child.

Q. Yes?

A. And Winifred the second. Sidney the third and Donald several years later. The early children were closer together, the girls being the oldest and the boys being the youngest.

Q. Bernardo Celli, Sr., had two children?

A. Yes.

Q. And in the order of their ages, would you please state their names?

A. Bernardo Celli, Jr., and Lloyd Celli were the two children.

Q. Now, prior to 1938 will you please state for the record what the activities, if any, of those children, all of them, were in the business of Cochran and Celli in a general way?

A. Well, at that time three of the boys were in the business, and——

Q. In 1937, are you referring to?

(Testimony of Joseph E. Cochran.)

A. Yes, 1937.

Q. And prior to that time?

A. Well after they had finished college or [19] schools, outside of vacations they were with us immediately after they got out of college in all cases. The girls—during and previous to that era they helped in the summer time, in vacations, but substituting, but on graduation from college they both became teachers and took jobs at that profession, so they were not with us.

Q. Now, were the Celli boys, that is, Bernardo Celli, Jr., and Lloyd Celli, also active in the business?

A. Yes, they were.

Q. When did they come into the business?

A. I can't remember the exact years.

Q. Were they in the business in 1937?

A. Ben, for several years Ben was very active—Ben was very active at that time. In fact, he was total head of the sales. He was sales manager, I believe, in 1938.

Q. What was Sidney in 1937?

..

A. In 1937 he came up as assistant sales manager. Before that he had been on the garage end of it, the repairs, and getting the new cars ready and stuff like that.

Q. What was the nature of the operations of the business, could you describe them for the record; that is, for the partners of the business?

A. Well, when we went in the automobile business we did not give up our blacksmith business. We built a new plant and continued, which was what

(Testimony of Joseph E. Cochran.)

we called our commercial sales division, [20] making bodies and trucks, and very early in our history I took on tires, so we had a tire department; and there came a time when Chevrolet demanded that I segregate the different businesses, so at that time I had a tire department, which was at one location, a body plant, which was at another location, and then the automobile agency, which occupied three different locations, one being sales, one service and parts, and one being storage and handling of trucks and getting new cars ready.

Q. And that is a description of your business in a very general way in the year 1937?

A. That is the way it stood in 1937.

Q. In 1937, Mr. Cochran, the partnership owned real property, did it not? A. Yes, it did.

Q. Do you have a present recollection as to the kind of real estate the partnership owned and used in the business in that year?

A. In that year?

Q. Yes, up to 1938.

A. I don't know the exact footage, but I can give you the locations and approximate footage.

Q. No, we don't want that.

A. You just want the buildings we owned?

Q. Yes.

A. A service department at 5th and Broadway which ran [21] through to 6th; quite an extensive plant we leased at the corner of 12th and Harrison, 10,000 feet, for sales purposes. We had our body shop at 8th Avenue and we had our new car storage

(Testimony of Joseph E. Cochran.)

and reconditioning and used car repair operations at 9th Avenue; and I believe we had the tire, yes, we bought the tire property at that time. I think we had used cars and a tire operation, quite a large lot, at 23rd Avenue and East 12th Street. I believe that was our holdings, outside of some nominal properties we may have taken in trade, like a house or so. That was our main holdings at that time.

Q. Now, Mr. Cochran, I call your attention to Petitioner's Exhibit 7, which represents the written articles of copartnership, made on the first day of January, 1938, between you and all of the members of your families with the exception of Donald, and all of the members of the Celli family, and I wish to question you about certain events leading up to the making of that agreement. Now that agreement—I withdraw that.

What was the reason and purpose for that agreement, Mr. Cochran?

A. Well, we, myself particularly and my partner, both felt that if possible we should try to interest our sons so that we could keep them in the business with us. In the first place, our franchise, in the case of either one of our deaths, hinged very much on if we had some of our own people trained so [22] they could go in. Salaries were not large at that time. The boys were paid as much as we could hire them in for, but it was not large. Him and I discussed in 1936—realized we went through from 1929 to '33, going on '34, a dead loss every year. We gradually cut back a little until in De-

(Testimony of Joseph E. Cochran.)

cember, 1936, we were just where we was in 1939.

The Court: In 1929, you mean?

The Witness: Our net worth in 1929 and our net worth in 1936, your Honor, were just the same. We had not—we started to make a little money in 1934, 1935 and 1936, enough to bring back our losses. We felt that if we were to keep our boys interested that they should be in the business and participating in the money we now were starting to make, in order that they could marry and get homes and have some money. Now, in Ben's case, he had the two boys and it meant he was taken care of. In my case, I had four children and I wanted my boys, if anything, to go the same as his. I had two girls. I couldn't do any different with my girls than I did with my boys. I had to do the same, so when we talked about money to do this thing—his boys' would be double what each one of my children would get, and that had something to do with the amount of investment to start. After we had talked this over for the latter part of '36 and '37, he had a good friend who was an attorney and we went to him for advice. And then, after some three or four months, the families talking [23] amongst themselves and we talking and having to go together with an attorney, we didn't know what was the best way to do it, but he said we could do it with the least expense if we would start with gifts within the law and then gradually go down the years. Mother's and my idea was to get our share of business, the business in six equal parts—

(Testimony of Joseph E. Cochran.)

that is what we was working for. We had the idea if we prospered we would like to have our children have some of that and use it as they grew up and raised families rather than wait until the end. It seems to me in that paragraph 5—

Q. Just a moment. Mr. Cochran, do you wish to refer to paragraph 5?

A. That is about control—

Q. Just wait a minute.

Mr. Freed: In order for Your Honor to follow this testimony, I think that it would probably—don't you agree, Mr. Nyquist—probably worth while calling His Honor's attention to the provisions of paragraph 5.

Mr. Nyquist: If you wish to read paragraph 5, I have no objection.

Mr. Freed: I think we should, because, as I understand it, respondent makes a very important point of that paragraph.

Paragraph 5 reads: "It is hereby agreed that J. E. Cochran and Bernardo Celli, Sr., shall have, and are hereby given, the exclusive management and control of the conduct of [24] said business and of any and all matters pertaining thereto, and the sole and exclusive power and authority to employ and discharge the employees of said co-partnership, and any and all thereof, including each and all of his co-partners herein as such employees; and to fix any and all salaries, including those of themselves and other co-partners; and the sole and exclusive power and authority to sign any and all checks, promis-

(Testimony of Joseph E. Cochran.)

sory notes or other evidence of indebtedness of said co-partnership; and the sole and exclusive power and authority to collect and distribute the assets and profits of said co-partnership among and between the said copartners, or any of them, and to make payment thereof, or of any part or portion thereof, to said respective co-partners; and the sole and exclusive authority to determine the necessity for, and to levy and collect assessments from the respective co-partners to provide for payment of losses or expenses; and the sole and exclusive power and authority to incur indebtedness for and in behalf of said co-partnership, and to make any and all contracts and agreements for and on behalf of said co-partnership, and to settle, adjust and compromise any and all disputes, claims and demands of whatsoever kind or nature in connection with said co-partnership or said co-partnership business; and generally, to do and perform any and all things necessary to be done or performed for the successful conduct, management, and control of said co-partnership business, including the right to [25] delegate to others the power to exercise all or any of the said functions; and in so managing and controlling said business, and in the performance of said duties, as aforesaid, the said J. E. Cochran and Bernardo Celli, Sr., and their successors as hereinafter provided for, will give their attendance, and to the utmost of their ability exert themselves for the joint interest, benefit and advantage of the parties hereto;

(Testimony of Joseph E. Cochran.)

said controlling parties or their said successors shall hereinafter be designated as 'Managers.' "

The agreement also provides, Your Honor, that in case of death of either of the managers there shall be succession to the office of manager—in the case of either partner dying, why, his eldest son will succeed him as the manager.

Q. (By Mr. Freed): Now, Mr. Cochran, you indicated you wished to make some statement with respect to paragraph 5. Would you please state to the court, if you can——

A. I would just like——

Q. ——the purpose and intent of that provision?

A. I just would like to make one statement because, Lord knows, Ben and I talked about it. We had went all these years without ever a dispute between us. Knowing that as the children grew and stress came on the business there might be questions come up that had to be decided between the two families—all we intended to ask in our contract, however our [26] attorneys handled it, was that the final decision should be settled between him and myself because we knew we could agree, and that is why the provision is in there, in the contract. The contract takes care of it. If it couldn't be adjusted, the partner dissatisfied has a way out. His partner can buy him out. We didn't think it would happen and it never did happen.

Q. Was there any intention in connection with paragraph 5 that either you or Ben Celli should

(Testimony of Joseph E. Cochran.)

have any personal advantage whatsoever from that provision?

A. No. On the contrary, when this contract was executed Ben, Sr. was signing checks, was hiring all sales forces.

Q. Ben, Sr.?

A. Ben, Jr. Ben, Jr. had been signing checks for several years. I don't believe Sid had, because he didn't happen to be in that end of the department, see. He was in charge of all sales, hiring and discharging, and for several years even up to that time the boys sat in on management, when we hired or discharged.

Q. At the time the partnership agreement was signed, was there any factor involved with respect to the maintaining of the equality of voice or vote between the two families; was that given any consideration in connection with this paragraph 5?

A. I didn't quite get that clear.

Q. I will rephrase that. In connection with paragraph 5 [27] of the partnership agreement, was any consideration given to the fact that the number of the partners in the Cochran family would be greater than that in the Celli family and that there would perhaps be a problem with respect to equality of voice in the business?

A. We knew in time it would be six to four and there couldn't be a vote, because we would have had six to their four and our thinking—if you get me right—we realized we had been doing business quite a while, all the boys going to school, but we didn't

(Testimony of Joseph E. Cochran.)

as we built up the business want something that might wreck it, and inasmuch as Ben and I had always been able to agree down through the years, twenty-five years and more, we felt in case of dispute my family would leave it to me and his family would leave it to him, and we could still go ahead, keep going, and not have the business disturbed or broken up, and that was solely our talk as we talked in those days.

Q. Was there any income tax consideration of any kind present in connection with the organization of this partnership?

A. There never was. The income tax—we realized we had lost money for several years and when we did start to make it we made very little. In that year, I don't know what it was but it was a nominal consideration. I never knew what it was even to think about it as far as I was concerned at that time.

Q. Did any of the other partners, to your knowledge, have [28] any concern with respect to income taxes?

A. The only tax that was talked about was gift tax, but income—from ourselves, we was only interested in how we could give it to the children with the least expense. That was the whole meaning at the time we entered into the partnership.

Q. You made some reference to the Chevrolet franchise and by bringing the children into the partnership it would——

A. Perpetuate that franchise. Mr. Hollers' school

(Testimony of Joseph E. Cochran.)

was based on that theory. All of our boys, with the exception of Ben, Jr., who couldn't be in the business, went to this school, were taught how to run the business and were sold on the business, so that if one of us dropped out there would be no question but that we were still able to run the franchise as Chevrolet wanted it run, and therefore it wouldn't be taken away from us.

Q. What do you mean by taken away from you?

A. If there occurs a death in the Chevrolet dealerships, and a man hasn't a son or son-in-law, the dealership is sold. The dealership belongs to Chevrolet Motor Company. It is their option what becomes of it. If they don't believe the people left are capable of running it, they get a man, buy you out for your book value. There are numerous cases right in this locality that have gone that way in the last two years.

Q. With respect to the rights to profits in that business before the partnership of Cochran and Celli, which is in issue [29] here—that is, which was organized on January 1, 1948—before that time was the division of profits and losses between you and Mr. Celli equal?

A. Always equal, regardless of how the accounts stood.

Q. And was it intended, as between the two families, that each family should be entitled to receive fifty per cent of the profits, if any, and share the burden of fifty per cent of the losses, if any, is that correct?

A. That's right.

(Testimony of Joseph E. Cochran.)

Q. Now, how old was your son Donald, do you remember, at the time the partnership agreement of January 1, 1938, was entered into?

A. Seventeen, I believe.

Q. He, of course, was not then admitted as a partner? A. No, he was not.

Q. He became twenty-one in 1941, is that correct? A. Yes.

Q. And he had been going to college, had he?

A. Yes, he had.

Q. Had he also been working in the business at all? A. During all vacations.

Q. What kind of work had he been doing?

A. Different places in the parts department—not exclusively, but that is where he helped mostly.

Q. And he became a partner in 1941 when he became twenty-one [30] years of age?

A. That's right.

Q. Or about the time he became twenty-one?

A. Yes.

Q. Now, in February of 1945 there was an amendment in writing, which is Petitioner's Exhibit No. 8; this amendment was to the articles of co-partnership, in which Donald was recognized as having been admitted as a partner in 1941?

A. Yes.

Q. And the various percentages of the interests of the partners in 1938 through 1943 were all stated?

A. That's right.

Q. As established and confirmed?

A. That's right.

(Testimony of Joseph E. Cochran.)

Q. Why was Donald not admitted as a partner in 1937?

A. Well, being a minor at that time, our attorney advised us he couldn't hold property, and he thought that the easiest way to do it was to bring him in when he became of age by gift from all of us; so actually we took his advice and followed that way.

The Court: What do you mean by "gifts from all of us"? All of whom?

The Witness: Judge, however the property stood at the time, when Donald became twenty-one we were each to give enough money to bring him up as soon as we could to the status of the [31] other children. We couldn't do it in one year. I think it took three years because otherwise you would have to pay a heavy gift tax, so we just brought him along as we could.

The Court: The Cochran family or the other family?

The Witness: The Cochran family. The other family had nothing to do with it. They owned theirs outright—fifty per cent.

Q. (By Mr. Freed): Now, you have stated, Mr. Cochran, that before the partnership agreement was signed there was discussion between the members of the families and there was discussion with your daughters, too?

A. Yes.

Q. Now, in 1937, I think you said Bernice was your oldest child?

A. Yes.

(Testimony of Joseph E. Cochran.)

Q. And what was her educational background in 1937?

A. Bernice was a graduate from University of California and took a Bachelor's Degree and taught in Oakland High School—not in Oakland High School but one of the high schools in Oakland, or two.

Q. She majored in mathematics?

A. Mathematics and chemistry, I believe.

Q. And she became married Christmas Eve, 1937?

A. Christmas Eve—the date of this contract.

Q. Now, Winifred, what was her [32] background?

A. Graduated from the same school, only in art and household science, and went immediately from the University of California to teach at Brentwood; took leave of absence there and took her Master's at Columbia, and from there came to the University of Davis.

Q. And there were discussions with your daughters before this agreement was signed?

A. How is that?

Q. And there were such discussions regarding the terms and provisions of the partnership agreement, is that correct?

A. My oldest daughter, perhaps, questioned it more than anyone because she would be married right at the start of it and we had gone through some bad times; we hadn't always been solvent. We had been very much in debt in the '30's and she

(Testimony of Joseph E. Cochran.)

questioned me whether she would be liable, whether her home would be liable if we hit bad times again, and I told her she would have to take her chances, she would be liable as I was if we was unfortunate enough to go that way.

Q. After the partnership was organized, with respect to the policy of drawings from the partnership, what was the policy, if it can be so designated, of the partnership in the matter of drawings?

A. Each partner had a right to draw within reason—I don't know that the contract provided it, but we had talked over about \$5,000—Ben and I—to be the extreme that anyone [33] would go to. Naturally, we had to work it as we had money, but all partners charged anything performed, work on their cars or anything like that that they needed from the business, and each had a drawing account. However, the girls didn't use the drawing account very much at the start because they were away from home teaching and had their own money. Later on they did use it consistently—in the early years, no. We were still trying to accumulate and get money to go on and we were all economical, ourselves included.

Q. Now, it is true, is it not, that salaries were paid by the partnership to those partners who worked in the business? A. That's right.

Q. And that included you—would you state what partners worked in the business and the policy, if any, with respect to salaries?

A. Anybody that worked in the business was

(Testimony of Joseph E. Cochran.)

paid on a straight salary agreed on between ourselves generally after talking it over with the boy. Ben and I never set the salaries, although the contract says so. We would talk it over with the boys and say, "What do you think is right?" But we never were a high salaried people at that time. We had come up from low salaries and we didn't, until later on, draw very high salaries. That applied to the boys as well as the owners.

Q. The daughters, of course, did not work in the business and did not receive any salaries? [34]

A. Well, they worked——

Q. I mean after the partnership was organized?

A. No, after the partnership, no. I don't think they did at all.

Q. Did you and Mr. Celli, as far as you know, have any outside investments, any investments other than investments in this business?

A. Outside of our homes, none—our homes or summer home—well, Mrs. Celli did, my partner's wife, but that came to her through an estate. That just came to her, but Ben and I—that was one of our understandings, that all the money we made we kept in our own business, did not invest in stocks or bonds or anything outside. That was our original agreement, the first one I wrote up, and it became a habit, because long before this agreement we had operated that way, but on our homes and that, why, we owned them and that is all.

Q. Yes. Now, after the partnership was or-

(Testimony of Joseph E. Cochran.)

ganized, to what extent, if any, was capital significant in the business? A. What was that?

Q. What was the importance of capital in your business after the—that is, during the existence of the partnership?

A. We had a crying need for capital because we operated heavy and until the war we never reached the place where we didn't have to borrow money to pay for the cars as they came from the factory, until the time we could resell them, so [35] naturally we were anxious to get in the position where we could pay cash for our cars, and we never did until we went through the war. Then we got to a place where we can pay for the cars and are there today, at the present time.

Q. Did you buy any substantial amount of real property after that partnership was organized?

A. Yes, we made our largest investment in real property after the partnership was formed.

Q. And when was that?

A. My mind is not—I think I am right when I say the spring of 1942. I could be wrong there, '42 or '43—'43. We bought an entire block.

Q. Would you please testify regarding that purchase of real property; how much did you pay for that real property?

A. \$200,000 for that block.

Q. That was purchased by the partnership?

A. Yes.

Q. That became a partnership asset, is that correct? A. Right.

(Testimony of Joseph E. Cochran.)

Q. That is, by the way, the main place of business, is it not—— A. That is.

Q. ——of the business of Cochran and Celli?

A. Yes, that is.

Q. What area does it cover? [36]

A. It covers a block bounded by Harrison on one side, Webster on the other, 12th on one side and 11th Street on the other, containing maybe 60,000 square feet of ground.

Q. And that property was improved, was it not, by the partnership?

A. It was entirely rebuilt.

Q. Do you know substantially, or just how much of an investment was in that real property altogether?

Mr. Nyquist: Objection, your Honor. We are going into matters now that were subsequent to the taxable years before the Court, and we can go into an endless amount of such questioning and it would have no bearing on the case.

The Court: He is talking about the importance of capital.

Mr. Nyquist: He is talking about investments made in improving real property——

The Court: The property used in the business.

Mr. Nyquist: But the investment was made subsequent to the years before the Court.

Mr. Freed: The witness just testified that the property was acquired in 1943. As far as that point is concerned, 1943 and 1944 happen to be years involved, and we are addressing ourselves now, as

(Testimony of Joseph E. Cochran.)

your Honor stated, to the importance of real property in this business and anything which touches upon the conduct of the parties under this partnership which will aid the Court in determining what their intent was with respect to the [37] investment in the business and the use of the investment and the importance of capital is all, we submit, most material in this case.

The Court: Well, I will let it in. I will give it consideration, the consideration I think it is entitled to. Overruled. What year are you referring to now?

Mr. Freed: The witness has testified about the purchase of this so-called block in 1943 by the partnership for about \$200,000 and I am now asking the witness if he can recall—and he has also testified that this property was substantially rebuilt, or rebuilt, and I am now asking the witness what the total investment was.

The Court: When were these improvements made?

The Witness: Improvements were made—started in December, 1945, and finished in August, 1946, your Honor.

The Court: What was the condition of the property as to improvements prior to that time?

The Witness: It was a similar business, but not laid out as we wanted it. One part of it was auto sales, one was storage, and one corner block, 100x100, was individual stores, some eight stores, and that building had to be entirely rebuilt for our

(Testimony of Joseph E. Cochran.)

purposes and the others had to be rebuilt to conform to the business we wanted to do.

The Court: Were you occupying the whole property from the time you purchased it? [38]

The Witness: Yes, we have occupied the entire block.

The Court: For business purposes?

The Witness: Yes.

The Court: The outlay of improvement, money, started in 1945?

The Witness: Yes, and it was more than the cost of the block, \$227,000.

The Court: What period of time did that cover, the expenditure for improvement?

The Witness: For improvement—we bought it in 1943. We started improvement in the latter part of 1945 and finished in 1946, with an expenditure of \$427,000 for the total investment.

The Court: I just wanted to get the segregation between the outlay for improvement and the purchase price.

The Witness: Yes.

Q. (By Mr. Freed): Bernardo Celli, Sr., died in August of 1945, didn't he?

A. That's right.

Q. And, unfortunately, it was February, was it, of 1946 that your wife died, Mabel Cochran?

A. March, the latter part of March.

Q. 1946? A. March 22.

Q. And it was Anna Celli, the wife of Bernardo Celli, Sr., who died in February of 1947? [39]

(Testimony of Joseph E. Cochran.)

A. That's right.

Q. Mr. Cochran, this is the first time, is it not, that the Treasury Department raised any issue of any kind with respect to the taxation of the income from the investments of your daughters in the partnership to your daughters, is it not?

Mr. Nyquist: Objected to as immaterial, whether this is the first time or not.

The Court: Objection sustained.

Mr. Freed: No further questions.

The Court: We will take a recess.

(Recess taken.)

Cross-Examination

By Mr. Nyquist:

Q. Mr. Cochran, I note from the stipulation of facts, Exhibit 1, a transcript of your investment accounts, that the transfers of interest from your account to your wife and children are entered under date of December 31, 1937.

Mr. Freed: May I ask that the record show the number of that exhibit?

Mr. Nyquist: Excuse me. That is Exhibit 1.

Q. (By Mr. Nyquist): Show the investments were made in the books under date of December 31, 1937, reflecting the transfers to the members of your family. Is that the date upon which you made the gifts?

A. Not if I am clear. We executed this contract December [40] 31—

(Testimony of Joseph E. Cochran.)

Q. December 31, 1937?

A. Yes, I think that is correct. It is either that or January 1. January 1st was a holiday. I don't know the exact date, but I meant it was the last day of '37. I think that is correct.

Q. The reason I am making this inquiry is your gift tax return shows gifts on December 24, 1937, and I was wondering which of those dates was the correct date.

A. Well, I wouldn't know. I have no way of testifying from memory as to that long ago. The attorney handled it. We signed a paper when he said "Sign." I don't know just as to the day it was executed.

Q. What year did you say that the partnership of Cochran and Celli was originally formed?

A. Now, you are talking about the first time we went together?

Q. When you and Mr. Celli went together.

A. Well, I said I originally bought the business and Ben came to work for me and we worked on a partnership working agreement for several years. At one time he took another little shop and run it on another street and we still continued to work together. We actually consolidated, we got money enough then so we had some fairly good sized operations, some ten or twelve men, and then we consolidated at First and Webster Streets. That was, I think, September, 1911. [41]

Q. And Mr. Celli—was not the year 1937 the

(Testimony of Joseph E. Cochran.)

most profitable year that the partnership had had up to that time? A. No, absolutely not.

Q. Can you recall what years were?

A. Surely, '28 and '29. We made \$81,000 in one year and \$84,000 the other.

Q. Then, from the period 1929 through 1937, was the year 1937 the most profitable year?

A. The way it was, each gained a little, 1935, 1936 and 1937; however, in 1938 we took a loss again.

Q. Well, Mr. Cochran, were you aware in 1937 that the total income tax burden on your family would be substantially reduced if the income were divided up among the members of your family?

A. I never even thought of an income tax in that time. I was so glad to make a few dollars, after losing for so many years, I was just tickled to death if I could make any money.

Q. You were particularly conscious of gift taxes?

A. No, only so far as I could execute it in the most reasonable manner. That is all. I was perfectly willing to pay whatever was necessary, but naturally if I could do it without spending too much money for gift taxes I wanted to handle it that way.

Q. Why did you have so much concern about gift taxes and not income taxes? [42]

A. I never made enough money that it was a big amount.

(Testimony of Joseph E. Cochran.)

Q. Had you ever paid substantial gift taxes before?

A. No, but in transferring you advise your attorney, "How can I do this with the least expense?" We still needed lots of money in the business, and his advice was a gift tax over a period of years—would be the most economical way to arrive at what I desired and my wife, too.

Q. Who was Charles E. Cornell?

A. He was a Certified Public Accountant that had our accounts at that time.

Q. Is he the man—he is the man who prepared your gift tax return for the year 1937, is he not?

A. Correct.

Q. Did you discuss the tax angle with him?

A. Never discussed anything with Charlie.

Q. Well, I notice in Exhibit 1 and Exhibit 2 that on December 31—Exhibit 1 shows increases in your investment account; Exhibit 2 shows increases in the investment account under the name of Mabel Cochran.

A. That is just turned around. The one I got, No. 1 is Mabel Cochran and No. 2 is J. E. Cochran—no, it isn't. I see up there it is Mabel Cochran. You are right, yes.

Q. Now, I notice the first entry in each of those accounts reflects a transfer from your account to the Mabel Cochran account of \$100,617.43, yes, and the following entries on the same [43] day, in each account, show transfers from each account to Sidney E. Cochran, to Winifred Cochran and to Bernice

(Testimony of Joseph E. Cochran.)

Johnson in the amounts of \$16,818.21, that amount being transferred to each of the children from each of the parent's accounts. Will you explain why you took the roundabout procedure of first transferring from your account to your wife's account and from there to the children's accounts, rather than making simply a direct transfer from your account to the children's accounts?

A. Evidently the lawyer and Charlie thought that was the right way to do it. I don't know books or bookkeeping. We simply did what they advised us to do. Charlie Cornell had the reputation of being one of the finest accountants in the city. I trusted my attorney on all details, naturally. I am not a bookkeeper. My—Freeman was in the office at that time and might be able to throw some light on it, but I simply did what they claimed was necessary to make this co-partnership, and if that was the way it was handled, it was undoubtedly handled under Cornell's advice. Why I don't know. I am not enough of an accountant to be able to tell you.

Q. Then you relied on the advice of——

A. My attorney and Charlie Cornell.

Q. Your attorney and your accountant?

A. Absolutely.

Q. As to your method of handling these transactions?

A. That's right. [44]

Q. You and Mrs. Cochran each filed a gift tax return for the year 1937. This has been stipulated in Paragraph 5 of the stipulation, that on March 15, 1938, you and Mabel Cochran each filed a gift

(Testimony of Joseph E. Cochran.)

tax return reporting three gifts in the amounts of \$16,818.21 each on each of your gift tax returns and claiming exclusions of \$15,000.00 and a specific exemption of \$35,454.63. You paid no gift tax on that transfer?

A. As far as I know we did not.

Q. That is within the amount of the exemption in each case? A. That's right.

Q. That is why the transfer was made to Mabel Cochran first, to get the benefit of the two exemptions?

A. That wasn't in my hands. It was handled by the attorney and the accountant.

Mr. Freed: I think the stipulation also recites the fact that the property owned by or standing in the name of J. Cochran was community property that belonged to him and his wife.

Mr. Nyquist: Yes, it is in the stipulation.

Q. (By Mr. Nyquist): Now, at the time of the formation of the partnership in 19—at the end of 1937, or the beginning of 1938, specifically what was your intention with respect to bringing Donald Cochran into the partnership? [45]

A. I talked about him to our family and with our attorney. When Donald became twenty-one we were to bring him in by gifts from all members of the family.

Q. Gifts of all the members?

A. Yes, until he had an equal share.

(Testimony of Joseph E. Cochran.)

Q. Until he had an equal share?

A. Yes, and doing it over a number of years, the number of years it took to do it and within the legal limits of our gifts.

Q. And that was your intention and understanding back in 1937, when the original partnership——

A. So specified—mentioned in the agreement.

Q. Now, again turning to Exhibit 1, your investment account, I note that on March 31, 1941, it shows a gift by you of \$4,000.00 to Donald Cochran and similar gifts by—the related Exhibits 2, 3, 4, 5 and 6 show similar gifts by your wife and by your three children in the amounts of \$4,000.00 each, making a total of \$20,000.00 to Donald Cochran.

Mr. Freed: 1941?

Mr. Nyquist: 1941.

Q. (By Mr. Nyquist): And then in 1942, it also shows gifts of \$4,000.00 each by you to each of your four children. Will you explain the circumstances surrounding the making of the gifts to each of your four children in 1942? [46]

A. Well, the law permitted us to give to a minor, and I think ahead of that you will find we gave to Donald Cochran and——

Mr. Freed: Pardon me just a moment. If I may ask the reporter to read back the testimony of the witness up to the point where I interrupted——

(Question and answer read.)

The Witness: I think, I know we were following

(Testimony of Joseph E. Cochran.)

a set program at that time, mother and I, to get our children an equal interest in our business, of giving each year to all children for the limit. The first year I think we were permitted to give five. We gave five as long as we were permitted to give five, and then we gave four and then we were permitted to give three. When Donald became of age it was agreed in the family we would give to him legally each year until he had accumulated an interest equal to ours, so the money given to Donald—one of them was the money I gave to him; the other was a gift that had been agreed upon in the partnership in transferring from each of us to that account, so that he could finally become on an equal share with us.

Q. (By Mr. Nyquist): Then, at the time you made a gift of \$4,000 to Sidney Cochran, Bernice Johnson and Winifred Irwin in 1942, and your wife made a similar gift of \$4,000 to each one of those children, you knew that they would at the same time make a gift of \$4,000 [47] apiece to Donald R. Cochran?

A. No, on the contrary, there was no such thing. Their gifts came ahead of that and it was not a gift, it was a way of transferring interest that had been given to them and was to be transferred to Donald Cochran when he became of age. My gift to my children had nothing to do with the money given to Donald Cochran because that was planned among ourselves at the time we made the

(Testimony of Joseph E. Cochran.)

agreement, merely handling and doing it as the attorney advised.

Q. Well, in 1942, each of the three children who were then members of the partnership made a gift of \$4,000 apiece to Donald, who was coming into the partnership——

Mr. Freed: Counsel, will you pardon me if I ask you to state the month and day in 1942 when that was done?

Mr. Nyquist: According to the record here, on March—on December 31, 1942—correction, on March 31, 1942, Sidney Cochran, Winifred Irwin and Bernice Johnson each made a gift of \$4,000 to Donald Cochran and on—excuse me, that was on March 31, 1941, and on March 31, 1942, they each made another gift in the same amount, making two gifts of \$4,000 apiece.

The Witness: And I think some in 1943.

Q. (By Mr. Nyquist): All right. Now, on December 31, 1942, did you and your wife each give a gift of \$4,000 to Sidney Cochran, Bernice Johnson and Winifred Irwin, making total gifts of \$8,000 to [48] each of those children?

A. The record substantiates the gifts. To get that clear, I will make this statement: Our program provided that we were giving to each of our children what the law allowed us to give in each of those years—\$5,000 I think the first year, then \$4,000 as long as it existed, and then \$3,000. Now, we gave that at the end of each year.

Q. And at the same time the three children who

(Testimony of Joseph E. Cochran.)

were already in the partnership were making gifts in the same amounts to Donald, were they not?

A. Only so far as to divide his interest equally to theirs, which was agreed when the original contract—it probably would have been clearer if we had handled it different but that is the way we were advised to handle it; in the original contract it so states that when he became of age that the other partners shall contribute to him until he has an equal amount.

Q. In other words, to take the Winifred Irwin investment account, for example, on March 31, 1941, and on March 31, 1942, she made gifts of \$4,000 each to Donald Cochran, did she not?

A. That's right.

Q. And on December 31, 1942, she received two gifts of \$4,000 each, one from you and one from Mabel Cochran, did she not?

A. That's right. That is exactly as it was set up.

Q. And the same was true in the case of Bernice Johnson [49] and Sidney Cochran?

A. That's right.

Q. And in 1943——

A. Didn't we give Donald the same at that time, too?

Q. Yes.

A. In other words we gave the four children each \$4,000, all at the end of each of those years.

Q. And three of those children——

A. Simply complying with the agreement. We

(Testimony of Joseph E. Cochran.)

were going to transfer to Donald his equity when he arrived of age.

Q. And I notice in January—on January 1, 1943, you and your wife made gifts of \$3,000 apiece to each of the children.

Mr. Freed: January what?

Mr. Nyquist: January 31, 1943.

Q. (By Mr. Nyquist): And you and your wife made gifts of \$3,000 apiece to each of the children. Did you know at the time you made those gifts that on the same day Winifred Irwin, Bernice Johnson and Donald R. Cochran—excuse me, Winifred Irwin, Bernice Johnson and Sidney Cochran, were going to make gifts in the amount of \$2,500 to Donald Cochran?

A. I knew that Donald hadn't gotten his full share and I knew whatever he lacked of his share there would be a gift made from the children to equal it. It had nothing to do with our gifts to our children, because, as I said before, we had a [50] plan and we followed it as advised by the attorney.

Q. Mr. Cochran, have you paid a Federal gift tax during any year?

A. No, I never have, not to my knowledge.

Mr. Nyquist: No further questions.

Mr. Freed: No questions.

(Witness excused.)

The Court: Call your next witness.

Mr. Freed: Sidney Cochran, will you take the stand, please?

Whereupon,

SIDNEY E. COCHRAN

was called as a witness on behalf of the Petitioner, and having been first duly sworn, testified as follows:

The Clerk: State your name and address please.

The Witness: Sidney E. Cochran, 8 Aztec Way, Oakland.

Direct Examination

By Mr. Freed:

Q. You are the son of Joseph E. Cochran and Mabel Cochran, are you not? A. Yes.

Q. And when were you born?

A. February 16, 1914.

Q. And what was your schooling, what was your educational background? [51]

A. Well, through the Oakland Public Schools and through the University of California, in Engineering. I graduated in 1935.

Q. And what department of engineering?

A. Mechanical Engineering, Automotive Engineering under Mechanical.

Q. And when did you first begin to work in the business of Cochran and Celli?

A. Well, on a full time basis in 1935, but naturally we grew up in the business, the business was going when I was born, so summer vacations and after high school—I worked a couple of semesters after high school in the garage and Saturdays, naturally. In other words, up until that time I had been in all different departments of the business.

(Testimony of Sidney E. Cochran.)

Q. You said, "We grew up in the business." Who are you referring to when you say "we"?

A. Well, particularly the Celli boys that were the same age or about the same age as I was—Lloyd Celli and Ben Celli, Jr.—were together at the business quite a bit of the time, and that is what I meant by "we."

Q. Did your sisters grow up in the business?

A. Yes, they did, and were working summer vacations to relieve the office personnel when they took their vacations.

Q. During the growing up period of your life at home, was the business a matter of discussion at all at home among the [52] sisters and your father and mother—that is, family discussion?

A. Well, it was probably the main topic of discussion at home. In other words, it was a family business, it was one of the main things that came up all the time, naturally.

Q. Now, did you train—was your engineering training in college directed to the goal of going into the business and using that engineering training in the business? A. Not necessarily, no.

Q. You got out and graduated from college in the depression, didn't you?

A. Just after the depression, yes.

Q. And then, did you go to work permanently or steadily in Cochran and Celli?

A. No, I worked for Pacific Gas and Electric Company for a short time.

Q. I don't know if you testified to this or not—

(Testimony of Sidney E. Cochran.)

when did you begin working steadily for Cochran and Celli?

A. I think it was the end of 1935 or the beginning of 1936. I am not positive of the date.

Q. At that time were any of the Celli boys working in the business?

A. Yes, both Lloyd and Ben Celli were working in the business at that time.

Q. Regularly? [53] A. Regularly, yes.

Q. However, your sisters were not then working in the business, were they?

A. No, I think they were both teaching at that time, say, the beginning of 1936—I am sure they were.

Q. And your father and Mr. Celli, Sr., were the owners of the business in 1935 and 1936 and 1937, were they not? A. That is correct.

Q. And did you work under them or did you work under someone else while you were there?

A. Well, when I started, naturally I worked under—I was in the service department; I worked under the service manager who was managing that department when I started. That is, the service salesman.

Q. And in the year 1937—let us come, say, to the latter half of 1937—what were your functions in the business?

Mr. Nyquist: Objection, your Honor. The respondent has admitted that these boys were partners and it is not going to add anything to the con-

(Testimony of Sidney E. Cochran.)

sideration of the case to go into all the details of their experience.

The Court: The question of the bona fides of the partnership doesn't affect the sons. I understand they are recognized as partners. What is the materiality of this?

Mr. Freed: I think in order to ascertain the true intent of these people—at least that is my view—it would be [54] helpful to have a complete picture of this thing, what was done. I don't wish to take up any unnecessary time, and I can see what counsel is driving at. I merely want to bring out that these children, the sons, had individual important duties in the business. That should be understood in connection with the provisions of the partnership agreement so far as such concepts as control and management are concerned on the part of the partners.

Mr. Nyquist: I will stipulate the sons had important duties in the business.

Mr. Freed: Will you also stipulate the sons signed checks, hired and fired, and acted on their own without consulting the so-called managers, the fathers, of the business and that they acted in a manner which is entirely different from what respondent asserts, that paragraph 5 of the partnership agreement would seem to hold. Would you stipulate to that?

Mr. Nyquist: What do you mean, would I stipulate——

Mr. Freed: That their conduct under paragraph

(Testimony of Sidney E. Cochran.)

5 is subject to—explains the meaning of paragraph 5 in the sense that the managers, the two parents, and the senior partners, reserved that right to make decisions for business purposes and that it was not a personal right which they reserved to control the gifts given to the children.

The Court: You are not stipulating to that?

Mr. Nyquist: Well, your Honor, under paragraph 5 the [55] senior partners reserved the control and also reserved the right to delegate certain of it. I have no doubt but what they delegated certain of it to these boys and I am willing to concede that, but they still reserved the right to control. I am willing to stipulate they authorized the boys to sign checks, yes.

Mr. Freed: Let us find out how the authority, if any, was given to the boys, whether the boys took it or whether it was given to them.

The Court: You are not contending on the part of the Petitioner, as I understand it, that the seniors, Messrs. Cochran and Celli, had the power to do all the things that paragraph 5 gave them the right to do? In other words, they could withhold the right of any of the junior partners to sign checks or to do anything else which paragraph 5 said that they themselves had the sole, exclusive right to do?

Mr. Freed: Under certain circumstances, if it was for the good of the business, yes, that would be our position. It was merely a legal reserved power for the good of the business, for the good

(Testimony of Sidney E. Cochran.)

of all the partners, including themselves, limited by other provisions of the agreement and the true meaning of which is explained by what the parties did with reference to paragraph 5 and the other provisions of the agreement. May I add this, your Honor, in cases of this kind, as we well know, it isn't the written word, it isn't those fine technicalities which are [56] controlling in matters of this kind; as I understand it, it is what the parties did, taking into account, of course, whatever legal instruments they signed, to ascertain what their intent was.

The Court: And also what they had the power to do.

Mr. Freed: Yes, what they had the power to do and what the purpose of it was.

The Court: Well, just what is your purpose? Nobody is disputing, as I understand it, that Mr. Sidney Cochran signed checks and did certain other things that were reserved, the power to do which was reserved, by the senior partners. Now, just what is your position?

Mr. Freed: I merely asked the question, to which counsel objected, what was his position in 1937. I wanted to see what position he occupied and what the partnership agreement meant to him when he signed it, and I could cover that very rapidly. I didn't intend to go so far afield. I perhaps should have asked him what was your position in the business in the latter part of 1937. Do you have any objection to that, Counsel?

(Testimony of Sidney E. Cochran.)

Mr. Nyquist: I have no objection to an individual question, but I have an objection to taking up time on a whole line of questions on an immaterial point.

Mr. Freed: I didn't expect we would get into an awful lot of discussion on that question. May I ask this question, with your consent, what was Mr. Cochran's position in the latter [57] part of 1937?

The Court: You don't have to ask his consent. You just ask the question. He may object if he wants to.

Mr. Freed: Then I will reframe my question and ask the witness——

Q. (By Mr. Freed): What was your position in the business of Cochran and Celli in the latter half of 1937?

A. I was assisting in the sales department. I don't know whether I had an official title at that time. I hadn't been in the sales department very long.

Q. Did you say assisting?

A. I was one of the assistants in the sales department.

Q. Who was your superior?

A. Ben Celli, Jr.

Q. Ben Celli, Jr.? A. Right.

Q. Now, I will refer you to Petitioner's Exhibit No. 7, the articles of co-partnership entered into the first day of January, 1938. You have read that agreement, have you? A. Right.

Q. Before you signed it? A. Yes.

(Testimony of Sidney E. Cochran.)

Q. Did you participate in discussions with members of the family before signing the [58] agreement?
A. Yes, I did.

Q. Was the agreement signed on the date of the agreement or before the date of the agreement?

A. Before the date of the agreement.

Q. Do you know about when it was signed?

A. No, I don't. I would say it was in the latter part of 1937.

Q. What was your understanding of paragraph 5 of that agreement before you signed it?

Mr. Nyquist: Objection, your Honor. His understanding of paragraph 5 is irrelevant.

The Court: Well, there is no ambiguity about it, is there?

Mr. Freed: Beg pardon?

The Court: There is no ambiguity in the language of paragraph 5, is there?

Mr. Freed: No, it isn't for that purpose. I will reframe my question.

Q. (By Mr. Freed): What was your intent——

Mr. Nyquist: Same objection, your Honor.

Mr. Freed: That is what we are driving at.

The Court: I think it is immaterial. I think that so far as particular partner relationships to the partnership are concerned—— [59]

Mr. Freed: I will withdraw that question and ask——

Q. (By Mr. Freed): What was the purpose of paragraph 5?

Mr. Nyquist: I object.

(Testimony of Sidney E. Cochran.)

The Court: Well, I will let him answer that. You may answer. I will overrule the objection.

The Witness: Well, the purpose, as I saw it at that time, was that in any business you can't have nine or—I think it was nine at that time, nine managers. You have to have a head of the business or the business head has to be delegated to a certain number of people in order to make the business work efficiently. For that reason the two senior partners, who had been in the business and had the experience of running the business, were delegated as managers to decide policy matters, with regard to—particularly where the other partners came in. In other words, somebody had to be the arbitrator if disputes came up; if both the junior partners wanted the same job, somebody had to settle that, and I am sure that was the reason that we saw at that time for delegating managers in the business.

Q. (By Mr. Freed): I don't know if the record shows this or not, but, Mr. Cochran, your family, the Cochran family, is not related—that is, has never been related to the Celli family, has it, by marriage? [60] A. No.

Q. And was there any social relationship at all between the Cochran family and the Celli family, or was it merely a business relationship?

A. The only social relationship was on business parties, or something like that, but not socially outside of business connections.

Q. Did the families visit each other?

A. Very seldom.

(Testimony of Sidney E. Cochran.)

Q. How did you acquire your interest in the partnership of Cochran and Celli?

A. By gift from my mother and my father, by gifts, various gifts. Pardon me, I will amend that; that was the original interest and subsequent interest was by gift and by income from the business. In other words, my share in the profits.

Q. And that—was that the way your sisters acquired their interest in the partnership, too?

A. That is correct.

Q. Now—withdraw that. You and Ben Celli, Jr., and your respective wives signed an instrument entitled “Declaration of Trust” which is Petitioner’s Exhibit No. 9 in this case. I will show you a copy of that; do you remember signing that declaration of trust? A. Yes.

Q. And that declaration of trust is attached to the [61] enumerated parcels of real property, up to and including parcel 10. Will you state the purpose of that arrangement?

A. Well, naturally, in any transfer of property it is necessary to have the owners of the property at that time handle the details of the transfer, particularly signing the papers and so on and so forth for one reason; and the actual physical handling of the property—it eliminated the number of signatures required on the transactions to four by having us the trustees for the property. As far as I can see, it was just an easier way to handle it than having the property owned by all of the partners it was owned by—I mean, we acted as trustees for them.

(Testimony of Sidney E. Cochran.)

Q. And you and Mr. Celli have acted as trustees, holding the title to that real property, for the benefit of your sisters as partners as well as all other partners?

Mr. Nyquist: Objection. The trust instrument speaks for itself.

The Court: Yes, the trust instrument, I think, will speak for itself.

Q. (By Mr. Freed): Your mother, Mabel Cochran, died in the early part of 1946?

A. Yes, that is true.

Q. Now, who inherited your mother's interest in the partnership? [62]

Mr. Nyquist: Objection, your Honor. We are going far afield again in subsequent years.

The Court: That is a question of law, isn't it?

Mr. Freed: Well, I will withdraw that.

Q. (By Mr. Freed): Was your mother's estate distributed—you were one of the executors, were you not, of your mother's estate?

Mr. Nyquist: Objection, your Honor. These matters took place two years after the years before the court.

The Court: What is the materiality of it, Mr. Freed?

Mr. Freed: I think it is quite material, your Honor. We are endeavoring to show what these parties did with respect to the interest in the partnership. We wish to show that Mabel Cochran left her interest in the partnership to her four children. It did not go back to J. E. Cochran as sometimes

(Testimony of Sidney E. Cochran.)

appears to be the case in some of these family partnership cases. It was distributed to her four children equally.

The Court: It was her property she left?

Mr. Freed: Yes, that's right.

The Court: And either by provisions of the will or by distribution under the statute it would go as so provided——

Mr. Freed: Had she left a will—and her two sons were executors under the statutes—it would go to her husband——

The Court: I don't see how that could affect the situation of the relationships of the partnership prior to that time. [63]

Mr. Freed: It shows the course of conduct. This will is a will made long before her death. We can bring that out, and that the property was left to her four children. It wasn't left to her husband.

The Court: I will sustain the objection.

Mr. Freed: If your Honor please, I wish to make an offer of proof for the record.

The Court: All right.

Mr. Freed: We offer to prove that Mabel Cochran, the mother of this witness, Sidney Cochran, the deceased—I suppose in some respects what could be called the deceased petitioner—made a will in 1938 leaving her interest in the partnership to the four children in equal shares and none of it was given in this will to her husband or anyone else except those four children; and that Mabel Cochran died in the spring of 1946 and that was

(Testimony of Sidney E. Cochran.)

her last will and testament; and that Sidney Elmer Cochran and Donald Robert Cochran, her two sons, were the executors of that will and that that estate was distributed by the executors and her partnership interest in Cochran and Celli was distributed equally to her four children, Sidney Elmer Cochran, Donald Robert Cochran, Bernice Cochran Johnson and Winifred Cochran Irwin.

The Court: The offer is denied. The record shows that the decedent died in 1946?

Mr. Freed: Yes, in March of 1946. [64]

The Witness: That is correct.

Mr. Freed: If your Honor please, I am always very sensitive to the record and Mr. Gebauer, my assistant, points out perhaps it wasn't stated clearly enough for the record that one of our purposes in offering this evidence was that it has a bearing on the element of control of the partnership interests and has a bearing on the power of disposing of the partnership interests as to whom it should go to and so forth. It all is part of the picture of these gifts.

The Court: I understand that Mrs. Cochran owned half of this partnership property to begin with, that is, half of the Cochran interest in the partnership property, by virtue of the community laws of California?

Mr. Freed: Yes.

The Court: Regardless of whether there was a partnership between her and her husband or not?

Mr. Freed: Yes.

(Testimony of Sidney E. Cochran.)

The Court: So in any event she would own that property whether it is community interest that she had or whether it is a partnership interest and I do not think that question of disposing—she can certainly make disposition of her own interest in community property and I am not sure just what the law of California is as to what disposition would have been made of the property under decedent distribution status if no will had been made—probably all would have gone to her four [65] children anyway.

Mr. Freed: No, it wouldn't. It would have gone to her husband.

The Court: I was not advised of that. I didn't know. You mean it would go to her husband to the exclusion of the children?

Mr. Freed: Yes.

Mr. Nyquist: You mean in the absence of a will?

Mr. Freed: In the absence of a will, yes.

The Court: Well, anyhow, she had the right to make distribution by will as owner under the Community Property Law of the State of California.

Mr. Freed: That's right.

Q. (By Mr. Freed): I will call your attention to July 1, 1948, Mr. Cochran. At that time there was a reorganization of the partnership business of Cochran and Celli, was there not? A. Yes.

Mr. Nyquist: Objection. Any reorganization that took place four years after the years before the court and when circumstances were materially changed by the death of three of the senior mem-

(Testimony of Sidney E. Cochran.)

bers of the families is completely irrelevant as far as this case is concerned.

Mr. Freed: May I reply to that?

The Court: Yes. [66]

Mr. Freed: In the first place, I would like to say that this case is somewhat peculiar, in that it goes back a considerable number of years to begin with, calling for these people to remember what happened a number of years before the years in question as far as the time element—relationship is concerned. Now, with respect to what the parties did after the partnership agreement, we are concerned here, obviously, with the question as to whether or not bona fide completed gifts or partnership interest investments were made to the daughters and any evidence which will show that the investments given to the daughters and kept on the books of the partnership and treated by the—and acts of the partners with respect to those investments thereafter which will throw some light on whether or not the girls actually owned those investments—the daughters did as much as the other partners did—is material and we are, of course, directing ourselves to the question of whether or not the daughters received exactly what the other partners received. When the partnership was reorganized and net worth in that partnership was transferred to a corporation, if they received stock for those investments just as the other partners did, if they received that stock in the same respect as the other partners did, and it became theirs in the

(Testimony of Sidney E. Cochran.)

same sense it did—as it became the property of the other partners and has always been such and there have never been any restrictions of any kind attaching to that stock, then we submit [67] it is most material to this case and the case would be incomplete without it.

The Court: I think it is highly doubtful whether it is really important or material here, but I am going to overrule the objection and let you show that this interest was recognized through this transfer of the interests of the partnership to the corporation and the issuance of stock representing the several interests. I will overrule the objection.

Mr. Freed: It was my understanding, Counsel, I was calling the witness' attention to that time of July 1, 1938, and asked him whether he recalled the reorganization of the partnership of Cochran and Celli at that time.

The Witness: Yes, I do recall.

Q. (By Mr. Freed): And what happened with respect to the reorganization of that business at that time?

A. The operating part of the business, that is, the Chevrolet franchise, our tire business and our body and trailer business—in other words, anything that was in the operating, manufacturing and distributing business was incorporated at that time into the Cochran and Celli Corporation.

Q. That was under the laws of California the corporation was formed? A. That's right.

(Testimony of Sidney E. Cochran.)

Q. And the stock was issued, capital stock of that [68] corporation was issued, was it?

A. That is true.

Q. And you received some of that capital stock?

A. I did, yes.

Q. And the other partners received capital stock?

A. All the partners in Cochran and Celli at that time received stock in the new corporation. I am not sure on the distribution—on the amount.

Q. But your sisters, Bernice Cochran Johnson and Winifred Cochran Irwin, received capital stock of the corporation for their net worth in the business which was transferred to the corporation, is that correct?

A. That is correct. They received amounts equal to what I received and Donald received. In other words, the business was split in two. As I understand it, there was a corporation and a partnership, which retained the building property and our finance division, which was at that time—in other words, it was a division between the operating companies and the property companies, essentially.

Q. I will show you what purports to be the stock certificate book of Cochran and Celli, a California Corporation, Mr. Cochran, and ask you whether you can testify from the stubs of that book how many shares of stock were issued to the—issued and delivered to the partners of Cochran and Celli?

A. All of them? [69]

Q. All of them.

(Testimony of Sidney E. Cochran.)

Mr. Nyquist: Objection, your Honor. The witness has already testified that stock was issued in proportion to partnership holdings. There is nothing to be added by going into all the details.

The Court: I do not think the number of shares makes any difference. All of the stock was issued to the former partners?

The Witness: That is correct. Actually, if I can answer that, it was distributed equally to the Cochran and Celli families; in other words, half to Celli and half to Cochran.

Mr. Freed: If your Honor please, I am going to offer into evidence—Mr. Goebel is a Certified Public Accountant for the company, but, in the interest of time I would like to offer this, which is a consolidated balance sheet, dated June 30, 1948, of Cochran and Celli, a Partnership, with a list of all of the investment accounts of all of the partners as of June 30, 1948; the opening balance sheet of July 1, 1948, of Cochran and Celli, a California Corporation; and the balance sheet dated July 1, 1948, of Cochran and Celli Investment Company, the partnership, which continued to exist under a changed name. We could save considerable time—

Mr. Nyquist: Objection, your Honor. It adds nothing material to what is already in the record.

The Court: I will sustain the objection. [70]

Mr. Freed: As I understand it, for the record, the objection was made, was based solely on the ground of materiality?

The Court: That is what I ruled on. I didn't

(Testimony of Sidney E. Cochran.)

hear any objection made as to the authenticity of it.

Mr. Freed: No further questions. You may take the witness.

The Court: Will your cross-examination take some time?

Mr. Nyquist: Not more than two or three minutes, your Honor.

The Court: All right. Proceed.

Cross-Examination

By Mr. Nyquist:

Q. Mr. Cochran, on direct examination you gave some testimony regarding the purpose behind paragraph 5 in the partnership agreement. I am not certain that I completely understood what your testimony purported to be; were you testifying as to your purpose or your understanding with respect to paragraph 5?

A. My understanding of the purpose of paragraph 5.

Q. You were not testifying as to the purpose or understanding of any other individual?

A. No, I can't do that.

Mr. Nyquist: No further questions.

The Court: That is all.

(Witness excused.)

The Court: We will adjourn until 2:00 o'clock.

(Whereupon, a recess was taken until 2:00 o'clock p.m.) [71]

Afternoon Session—2:00 o'Clock P.M.

The Court: You may proceed.

Mr. Nyquist: Apparently Mr. Freed and Mr. Gebauer have not returned.

The Court: Well, we will wait a minute.

You may proceed. Call your next witness.

Mr. Freed: Mrs. Johnson.

Whereupon,

BERNICE COCHRAN JOHNSON

was called as a witness on behalf of the Petitioner, and, having been first duly sworn, testified as follows:

The Clerk: State your name and address, please.

The Witness: Bernice Cochran Johnson, 5145 Proctor Avenue, Oakland.

Direct Examination

By Mr. Freed:

Q. Mrs. Johnson, you are the person designated as Bernice M. Cochran in Exhibit 7 and evidence, referring more specifically to the articles of co-partnership dated January 1, 1938? A. I am.

Q. What was your date of birth?

A. August 20, 1910.

Q. In the latter part of 1937, where were you living?

A. I was living at home, which was at that time—was 8 Aztec Way, Oakland. [72]

Q. With whom were you living at that time?

(Testimony of Bernice Cochran Johnson.)

A. Members of the family at home, with my mother and father and brother, Donald.

Q. Was Sidney already married?

A. Sidney was married. Winifred was working and came home week ends. She lived in Brentwood.

Q. Were you following any occupation at that time?

A. Yes, I was a teacher in the Oakland Schools at that time at Fremont High School. I was a counselor and teacher.

Q. Were you self-supporting at that time?

A. Yes.

Q. And you had graduated from the University of California? A. Yes.

Q. What degrees did you have?

A. I graduated in 1931 and received my B.A., and the following year I received my Secondary Credential and my Master's in mathematics.

Q. Master's Degree? A. Yes.

Q. During the years up to and including 1937, as you were growing up and living with the family, did you become familiar as a family matter with the business of Cochran and Celli?

A. We were brought up with the business. It was an everyday topic of conversation. I don't think there was a dinner that business wasn't discussed; that is, how it was going, various business [73] matters.

Q. Now, prior to the time that you signed the articles of co-partnership, Petitioner's Exhibit 7, did you read that agreement?

(Testimony of Bernice Cochran Johnson.)

A. Yes, I read it.

Q. And, by the way, when was it if you recall that you signed the articles of co-partnership?

A. You mean the date?

Q. What month, for example?

A. To the best of my memory, it was about November of 1937. The articles came into effect on January 1, 1938.

Q. Where was it that you signed the agreement?

A. We signed the agreement at the attorney's office, Mr. Wilson's office, of the firm of McClymonds, Wells and Wilson in Oakland.

Q. Did you participate in any discussions with members of the family regarding the agreement prior to the time that you signed it?

A. Yes, from the time of its first consideration it was discussed in the family at home. We had many conversations.

Q. What was the name of the attorney at whose office you signed this agreement?

A. Mr. Wilson, Mr. Leo Wilson.

Q. Leo Wilson; do you recall who else was present at the time you signed the agreement?

A. I believe that it was my father, mother, my sister and myself and the attorney. [74]

Q. Did you go into any of the provisions of the agreement to ascertain the meaning of them prior to the time that you signed the agreement?

A. Well, the provisions were discussed at home; that is, the setup of the partnership, and then at the time we visited the lawyer's office we went over

(Testimony of Bernice Cochran Johnson.)

with him in great detail and asked questions so that we were sure we understood the provisions, the legal terminology of them.

Q. To your knowledge, was any reference ever made to the subject of income taxes in connection with the making of this agreement of partnership?

A. I didn't ever hear income taxes mentioned.

Q. Did you understand how you were acquiring an interest in the partnership of Cochran and Celli?

A. Yes, I understood that we would receive gifts from my mother and from my father of an interest in the business, which would make our investment in the business by the way of gifts from them.

Q. Did you raise any questions at all concerning the effect of the partnership agreement on you prior to the time you signed it?

A. Yes.

Q. Do you recall any such matters as that?

A. Well, I was being married at the same time the partnership was being formed and so I was a little bit concerned, [75] particularly about the liability. We had just come through a depression when business hadn't done very well, so I found out what the liability consisted of, talked it over with my husband-to-be and decided to become a co-partner.

Q. Do you recall the purpose of that provision of the agreement, more specifically the paragraph numbered 5 which appointed your father and Bernardo Celli, Sr., the managers; do you recall that provision of the agreement?

A. Yes.

Q. Now, would you state the purpose of that

(Testimony of Bernice Cochran Johnson.)

paragraph according to your knowledge of it, in signing that agreement?

A. I can't remember the exact paragraph stressed. My understanding was that for the best interests of the business, that is, so that it could run most successfully, my partners—of course, nine partners were an unwieldy number, so that it was better to have one representative from each family; that is, my father would represent our family and Mr. Celli would represent his family, in order to run the business for the best interests of all parties. I thought that the difference in weight of the families as far as the membership in the partnership had something to do with making that provision.

Q. In what respect as to the difference in numbers or weight?

A. At the time of the forming of the original co-partnership the Cochran members were five and the Celli members [76] were four, and when Don became of age he would become the sixth Cochran member so that we outnumbered the Cellis. There had to be an equal representation between the two families and it was natural, because of the two senior members—they were the ones appointed at that time.

Q. Following the organization of the partnership and the gift or gifts to you and your sister from your mother and your father, what did you regard as your contribution to the business, to the partnership, following that time?

A. My contribution I thought was equal to that

(Testimony of Bernice Cochran Johnson.)

of the other partners in that I had a capital investment in the company which was earning capital for the business, and also I left the profits in the business to build the business up to the present size. That was the policy we all followed.

Q. Did you have any occasion to keep in touch with your investment in the sense to know what was happening to it according to the books and financial reports of the business after the time the partnership was organized?

A. Yes, I could at any time have asked or investigated; as a matter of fact, probably once a year, after the yearly reports were made up I saw the financial statement of the business and particularly the standing of my investment. Sometimes I did that at the office at Fifth Street. I would come up there and be told that the books were ready and I would look at them, and later on I had the reports—saw them at home. [77]

Q. And I believe you testified that you left your investment in the business?

A. That is correct.

Q. Could you have withdrawn your investment?

A. Yes. I understood that from the beginning, that it was my money and that if I needed it for anything or wanted to, if I wanted to withdraw it I was free to do it. Of course, it was a good investment and I have a great interest in Cochran and Celli, so it was left there except for such withdrawals that I deemed necessary. During all this

(Testimony of Bernice Cochran Johnson.)

time I was married, my husband was making an adequate salary. We saved during all those years on his salary. There wasn't any need for withdrawals during the first years. Later on we withdrew more money, more and more.

The Court: You are not referring to the original capital invested?

The Witness: I could have withdrawn the capital, yes. There were provisions in the co-partnership at any time I could withdraw money if I wanted to.

The Court: You could withdraw from the partnership and take your investment out of it?

The Witness: Yes, I could have retired and given notice and there are provisions in the partnership wherein I could receive my total investment over a period of five years. [78]

Q. (By Mr. Freed): You made some reference to withdrawals. During these years that we have before us, 1942, 1943 and 1944—excuse me a moment.

Mrs. Johnson, referring to Petitioner's Exhibit No. 13, which is the summary of annual withdrawals from your account on the books of the partnership, I believe that you testified that as the years went on you increased your drawings?

A. Right.

Q. That is, as the years went on? A. Yes.

Q. Now, will you state some of the purposes for which you made withdrawals?

A. Starting——

(Testimony of Bernice Cochran Johnson.)

Mr. Nyquist: Objection, your Honor. I object to the question that broadly stated. If it is confined to the years up to 1944 I have no objection, but if it is for the purpose of withdrawals subsequently, I think that they are irrelevant.

Mr. Freed: At this time I am referring to Exhibit 13, which only includes 1944. I have no intention of referring to any years thereafter with this question. This question is limited to up to the year 1944.

Mr. Nyquist: No objection if the question is so limited.

Q. (By Mr. Freed): I am referring to this exhibit. Look at it. Starting with 1937—1938, it started at 1938. There are no withdrawals [79] in 1938, and in 1939 there were \$52.33 withdrawn for taxes, 1940, \$129.61 withdrawn for taxes; 1941 there was \$621.87 for taxes, and \$4,000 as a gift to your brother, Donald. Then, in 1942—let's look at 1942. Do you remember—1942, by the way, refers to \$2,314.04 for taxes, and there was a gift to your brother, Donald, wasn't there?

A. That's right, of \$4,000. Then, we also received \$1,000, each of the partners, at the end of that year, received \$1,000, at the end of 1942, from the business.

Q. By "we," you mean all of the members of the Cochran family?

A. I believe so. I know the four children did and the Celli boys received \$2,000 each and I believe the senior partners, the parents, also received some,

(Testimony of Bernice Cochran Johnson.)

but I am not sure. Then, in 1943, we gave a gift to Don of \$2,500 and then business was good and about the middle of the year it was decided that we would each receive—that is, my sister and myself that I know of—\$100 a month from our drawing account, and from then on to the end of the year we received that. The cost of living was going up in that year. At the end of the year we received a lump sum of \$600, so during that year we received \$100 a month and we continued to draw that much until—let's see, that was in 1945—about the middle of the year, we received \$200, then we received \$250—we have made those withdrawals all through those [80] years.

Q. I am not sure whether the record shows it or not, Mrs. Johnson, but did you receive an executed copy of that partnership agreement?

A. Yes, I received one signed by all the partners.

Q. You also signed another agreement, which is an exhibit in evidence here, an amendment to the partnership agreement, Petitioner's Exhibit No. 8. That was dated February 28, 1945. Donald was a party to that?

A. Yes.

Q. And you received a copy of that, did you?

A. Yes, I received a copy.

Q. Did you testify as to whether or not you received the annual financial reports from the partnership? I don't remember, did you?

A. Financial statements?

Q. Yes.

A. Yes. During this period I believe that I did.

(Testimony of Bernice Cochran Johnson.)

I have seen them and had access to them, and during the later years—I am sure that in 1944, I had the financial statement for that, and in the years just before I can't remember.

Q. Yes. Now, on July 1st, 1948, you transferred a substantial part of your interest in the partnership to Cochran and Celli, a California Corporation, did you not? A. That's right.

Q. And you received shares of stock from the corporation [81] for that share of net worth which you transferred to the corporation, did you not?

A. Yes.

Q. Do you remember how many shares you received?

A. Well, 768 $\frac{3}{4}$ shares, at about a par value of \$100 a share.

Q. You continued to remain a partner in the partnership, did you not, after—that is, in association with the same partners; that is, the partners then, who were partners on July 1, 1948?

A. You mean——

Q. What happened at that time?

Mr. Nyquist: Objection, your Honor. There is no point in going into such great lengths as to these matters in 1948 and subsequently.

The Court: Well, it is rather remote, I think, but I will overrule it.

The Witness: Well, at that time it was decided for the best interests of the business that the operating part of the business, the Chevrolet dealership and related parts of the business, be formed into a

(Testimony of Bernice Cochran Johnson.)

corporation, and steps were taken to make that part of the business a corporation. The individual partners' shares in the business were then translated into stock in the corporation and we received that. Part of our interests remained in the partnership, which held the real [82] property, the buildings and land, and the financial department was also kept in that division and still is. About half of our interests.

Q. (By Mr. Freed): The name of the partnership was changed, was it?

A. Yes, it became the Cochran and Celli Investment Company, the partnership.

Q. And the corporation continued——

A. As Cochran and Celli.

Q. In addition to your testimony regarding your receiving or having access to and reading financial reports of the corporation, did you keep in touch with the business of the partnership by consulting any of the other partners during the period, say, from January 1, 1938, up to the end of 1944?

Mr. Nyquist: Objected to as leading.

The Court: Sustained.

Q. (By Mr. Freed): What, if anything, did you do—what you have testified to—in the sense of showing an interest in the partnership?

A. Well, for instance, I would come down to the garage, look around to see what kind of service people were getting, and if I didn't think things were going right I would let the people know who were responsible for that. I would ask different people

(Testimony of Bernice Cochran Johnson.)

in the business, whenever I was down there, [83] about different phases of the business, how things were going, and also whenever I was with any of the other partners the business was discussed. We also—any problem coming up was discussed, any labor situation or anything to do with the factory, number of cars they were able to get. Of course, during that year there were no cars delivered but the storage problem was something, keeping those cars in good condition.

Q. What year are you referring to now?

A. This was during the war years. The previous years the same thing was true. That is, family business was discussed whenever the family was together, and I asked questions. I was interested in my investment. I wanted to be sure everything was going along to my best interests as well as the best interests of the business.

Mr. Freed: You may take the witness.

Cross-Examination

By Mr. Nyquist:

Q. Mrs. Johnson, did you regard your investment in this partnership as a good, sound investment?

A. I certainly did, and the years have borne me out, I think you will admit.

Q. And were the operations of the partnership conducted harmoniously among various members of the two families that were involved?

(Testimony of Bernice Cochran Johnson.)

A. Yes. I have never heard of any dispute. Everything [84] is talked over and decided amicably.

Q. Did you believe that was the way it was going to work out at the time you entered into the agreement in 1937?

A. At that time I could see no reason that that wouldn't continue. I believe a provision was made in the partnership agreement if anything like that did come up we would look at all sides of the problem——

Q. But you at that time had no real expectation you would have any occasion to withdraw your capital from the business?

A. I didn't, not at that time.

Q. I note from the investment accounts that you made gifts of \$4,000 apiece to your brother, Donald Cochran, on March 31, 1941, and March 31, 1942, and another gift of \$2,500 on January 31, 1943.

A. That's right.

Q. Will you explain the circumstances surrounding the making of those gifts, how that came about?

A. Well, from the beginning it was understood that the children were to share equally in the business and we knew when Donald became of age—that was our understanding among ourselves—he would be taken into the business and would receive a share equal to the rest of the children's, and that was the means of attaining that end.

Q. You mean the means was through, the par-

(Testimony of Bernice Cochran Johnson.)

ents and the other children transferred interest to Donald, and through the [85] parents transferring interest, additional interest, to the children to——

A. Well, of course, the parents' transferring their interest to us was an overall pattern at the time Donald became of age. I thought it was a good idea personally because it gave us the feeling we were all taking Donald into the partnership.

Q. But the transfers, the two \$4,000 transfers, from your parents to you which were made at about the same time, that is, within the year following the two gifts of \$4,000 from you to Donald, did you have any—was there any understanding that existed at that time with respect to these gifts?

A. No, the first gift was made—Don became twenty-one and we each gave him \$4,000 from our share of the investment and then a year later we gave him another \$4,000. At that time I knew nothing about receiving something additional from my father. It had been some years there between gifts, as you will see if you look. It was December when we were given \$4,000 from our parents. We gave Don \$4,000 in March of 1941 and March of 1942.

Mr. Nyquist: I have no further questions.

Mr. Freed: No further questions.

The Court: That is all.

(Witness excused.)

The Court: Next witness. [86]

Mr. Freed: Mrs. Irwin, please.

Whereupon,

WINIFRED COCHRAN IRWIN

was called as a witness on behalf of the Petitioner, and having been first duly sworn, testified as follows:

The Clerk: State your name and address, please.

The Witness: Mrs. Winifred C. Irwin, 535 Oak Avenue, Davis, California.

Direct Examination

By Mr. Freed:

Q. Mrs. Irwin, you are the same person designated as Winifred Cochran in Petitioner's Exhibit 7, which is the articles of partnership of Cochran and Celli dated the first day of January, 1938?

A. Yes.

Q. When were you born, Mrs. Irwin?

A. March 10, 1912.

Q. And what is your educational background?

A. I am a graduate of the University of California, with a secondary credential in the State of California in art and decorative art, and I have a Master's Degree from Columbia University in New York City.

Q. Where were you living in 1937?

A. I was living in Brentwood, California, taught school, but I was home on week ends. [87]

Q. How far is that from Oakland?

A. Fifty miles.

Q. Your home was in Oakland, was it not?

A. Yes. My permanent residence was Oakland.

(Testimony of Winifred Cochran Irwin.)

Q. When did you begin—when did you go to Brentwood, let me put it that way?

A. I went to Brentwood originally in 1935—1934, after I graduated from college.

Q. And in 1937 you were self-supporting, were you?

A. Yes.

Q. And you were not yet married?

A. No.

Q. Up to January—were there any periods of time—withdraw that.

Were there any occasions prior to January 1, 1938, when you did any work in Cochran and Celli, the business of Cochran and Celli?

A. Well, up until—through my freshman year in college I worked at Cochran and Celli in the summertime, in the office. I generally took someone's place who was on vacation. However, there were positions such as receptionist, telephone operator or file clerk; then also I went to Cochran and Celli during those years during the inventory period, in January, when we also had vacations at school.

Q. Did you receive any compensation for your work? [88]

A. Yes, I did.

Q. Did you take any training or did you go to any school or—aside from those you mentioned—that is, for a commercial purpose?

A. No, only in high school I did take some commercial courses, mainly typing and office experience courses.

(Testimony of Winifred Cochran Irwin.)

Q. Did those courses have any relationship to the work you were doing in Cochran and Celli?

A. Well, perhaps, only in so far as it might have helped me at the times that I worked there. It was a similar type of work.

Q. In the latter part of 19——. Withdraw that.

Do you remember approximately when it was that you—what month of 1937 you first saw this typewritten document called Articles of Co-partnership, Petitioner's Exhibit 7?

A. Well, it was in the latter part of 1937. It could either be the late part of November or the early part of December of that year.

Q. Do you remember about when it was that you signed that agreement?

A. Well, as I remember, it is approximately the same time—I am not absolutely sure. I believe it was in November.

Q. In any case, before January 1st?

A. It was before January 1st and before Christmas of that year. [89]

Q. Prior to the time that you signed that agreement, did you read it?

A. Yes, I have read the agreement.

Q. And, by the way, where was it you signed the agreement, do you remember?

A. At the attorney's office in Oakland.

Q. Mr. who? A. Wilson.

Q. You have been in the courtroom during the day and you have heard reference made to that

(Testimony of Winifred Cochran Irwin.)

provision of the articles of co-partnership which designate your father and Bernardo Celli, Sr., as managers, and you have heard other witnesses testify regarding that, is that so? A. Yes.

Q. However, before you came—at the time you signed this agreement did you understand the purpose of that paragraph in the agreement? Was there any discussion regarding that paragraph?

Mr. Nyquist: I object to the question. It is vague. The purpose of the paragraph—the paragraph itself doesn't have a purpose; some individual may have a purpose with respect to a paragraph, but if the question is directed to the purpose of any individual, let us be specific as to whose purpose.

Mr. Freed: If you want to be technical, I will withdraw the question. [90]

Q. (By Mr. Freed): What has been your understanding of the purpose of paragraph 5 of the partnership agreement, if you have an understanding of it?

A. Well, my understanding of it mainly is that in a large business that was to be owned by a group of partners it seemed wisest to have two people to act as managers and to make the decisions, because two people can make decisions easier than a whole group of people, and it was my understanding that it was a device for managing the business in an economical and in a fair manner, and also the inequality of numbers in the membership of the

(Testimony of Winifred Cochran Irwin.)

partnership may have had something to do with it at that time. That is, so that each family would be equally represented by the two senior members who had the most experience in the business, and we all recognized that at the time.

Q. Now, did you keep in touch with the partnership affairs after you signed the partnership agreement?

A. I was particularly interested in the financial progress of the partnership, yes. Financial statements at the end of the year, which I received.

Q. Were you in touch with any of the activities of the business relating to the acquisition or sale of any of the property of the partnership?

A. Yes. Whenever a new piece of property was to be purchased we all knew about it ahead of time. We knew where the [91] property was and we entered into discussions about the purpose of that property and what was to be done with it, and why it was to be purchased and so on.

Q. What kind of property are you referring to?

A. Well, especially in 1943 when Cochran and Celli acquired their present business location.

Q. You are referring to the real property?

A. Yes, realty.

Q. You say—is it your testimony that you were in touch back in 1943 with the acquisition by the business of that block of real property?

A. Yes, particularly with my brother Sidney, who was very much interested in acquiring it at the time, along with other members.

(Testimony of Winifred Cochran Irwin.)

Q. Do you remember the circumstances, for example, under which that property was acquired, that is, to the extent you were in touch with them?

A. I knew about it only ahead of time. I did not know about it at the time the final decision was made, just to the extent of discussing it beforehand.

Q. Were you familiar with the location?

A. Yes, sir, and also there were certain circumstances attending that purchase, the location where Cochran and Celli had its main office buildings and its service buildings was to be used as an overpass area for the new highway that was to go [92] through Oakland, and we had all known for a long time that was to be condemned, and it wasn't going to be desirable, a desirable place to operate a business, and we had known that for some time and that is one reason why Cochran and Celli had been looking around for another location.

Q. Were you familiar with that location when acquired in 1943? A. Yes, because——

Q. Had you investigated, yourself, for example, or expressed an opinion regarding it?

A. Well, I knew the location because Cochran and Celli formerly leased a building on the opposite corner for their sales room and also there was a small used car sales room in the same place, directly across the street, so I knew the location and also I knew the building and the place at the time of purchase.

(Testimony of Winifred Cochran Irwin.)

Q. Did you participate in any discussion with any of the other partners prior to the time that Cochran and Celli purchased that block of property?

A. Yes. Besides my brother that I mentioned.

Q. Was it just your brother Sid you referred to?

A. No, there were other members of the family.

Q. For example, who else did you talk to about it?

A. Well, my other brother, Donald Cochran, and I know my brother and I discussed it at the time, were very much interested [93] in it, and my father, I undoubtedly discussed it with him.

Q. Did you take a look at it, for example, before you bought it?

A. Yes, I remember the building very well as it was before Cochran and Celli bought it. I knew the location.

Q. You have heard your sister, Mrs. Johnson, testify regarding the matter of drawings from the business by her? You have heard that testimony?

A. Yes.

Q. Would your testimony be substantially the same as hers regarding your drawings?

A. Yes, it would be. During those years in which the partnership was first formed I had my own job and was self-supporting and didn't feel the need for withdrawing any money from the business other than my car needs and that sort of thing.

Q. Did your drawings increase as time went on?

(Testimony of Winifred Cochran Irwin.)

A. Yes, during the forties they have increased. However, it has been a company policy to allow our money and our profits from the business to be used for business expansion, and that was a company policy since the inception of Cochran and Celli, and particularly in the years when the firm was beginning to get on its feet financially and make money and to think about new expansion, because, among other things, the need was for a new location and they needed money, needed capital, to do that. [94]

Q. Now, when the operating divisions or departments of Cochran and Celli were reorganized into a corporation on July 1, 1948, did you receive stock for your share of net worth in the partnership? A. Yes, I did.

Q. And do you have any recollection of the number of shares you received?

A. Yes. It is approximately 768 shares.

Q. How many? A. 768 shares.

Q. With a par value of how much?

A. \$100.

Q. And you received a share certificate for those shares, did you? A. Yes.

Q. You still have it? A. Yes, I do.

Q. Delivered to you personally, was it?

A. Yes. I keep it with my other valuables in a safety deposit.

Q. Was there any understanding between the partners as to whether you or your sister were to receive any salaries, for example?

(Testimony of Winifred Cochran Irwin.)

A. Yes, there was an understanding to that effect. Any partner that rendered services to the business was to receive a [95] salary, and had I elected to work for Cochran and Celli after my graduation from college I would have received a salary at that time. For the partners that were not working partners, they would share only in the profits of the business and receive only their share in that, their capital investment account percentage of the capital investment allowed.

Q. Now, did you receive—withdraw that.

To what extent, if any, did you maintain a familiarity with the financial affairs of the corporation—I mean the partnership, not the corporation, the partnership, through financial reports or statements?

A. Well, I was interested in my particular financial report and the increase in my investment from year to year and the overall picture of how the business was operating and its growth, the growth of the business.

Q. And how often did you see financial statements or reports?

A. Generally speaking, once a year, although I could have seen them at any time.

Mr. Freed: You may take the witness, Mr. Nyquist.

Mr. Nyquist: No questions.

(Witness excused.)

Mr. Freed: I call Mr. Bernard Celli, Jr., as a witness.

Whereupon, [96]

BERNARDO CELLI, JR.

was called as a witness on behalf of the Petitioner, and having been first duly sworn, testified as follows:

The Clerk: State your name and address, please.

The Witness: Bernardo Celli, 1900 Melvin Road, Oakland.

Direct Examination

By Mr. Freed:

Q. Mr. Celli, you are the Bernardo Celli, Jr., mentioned in the articles of co-partnership of Cochran and Celli, are you not? A. I am.

Q. You are the senior surviving member of that family, are you not? A. That's right.

Q. That is, Bernardo Celli, Sr., your father, passed away in August of 1945, and your mother passed away in February of 1947, is that correct?

A. That's right.

Q. Your brother Lloyd is still living, is that correct? A. Yes.

Q. When were you born?

A. June 18, 1911.

Q. And there were only four members of your family, were there not? A. That's right.

Q. Up until the death of your father? [97]

A. That's right.

Q. That is, your father and mother and you and your brother Lloyd? A. Right.

Q. And your family has been unrelated to the Cochran family by blood or by marriage?

(Testimony of Bernardo Celli, Jr.)

A. That's correct.

Q. How long have you known the members of the Cochran family; that is, the children and the parents?

A. Ever since I can remember. We were children together, at least the Cochran children and my brother and I were all children together. I can't give it to you, the number of years, but it is over thirty years.

Q. Now, you and your brother Lloyd worked in the business, didn't you? A. Yes.

Q. Did you work in the business and did your brother work in the business during the school period of your lives?

A. I worked in the business ever since I can remember. I remember going down as a small boy and working around the shop every day after school until my college days and then I only worked about two years after—of my college afternoons, and all during vacations.

Q. Do you remember the children of the Cochran family also working in the business? [98]

A. Yes, I do.

Q. During the school years?

A. Yes, I do. They used to come down on Saturdays and holidays—not holidays, but vacations, and after school.

Q. Do you remember the girls, that is, Bernice and Winifred, coming down to the place of business during their earlier years?

A. Yes, and working in the office.

(Testimony of Bernardo Celli, Jr.)

Q. You participated in the formation of the Cochran and Celli partnership by virtue of that partnership agreement dated the first day of January, 1938? A. That's right.

Q. And prior to the formation of that partnership did you take any part in any discussions with respect to the formation of that partnership?

A. Yes, I did, definitely. We discussed it with the attorney, among our family, and with Mr. Cochran and Sid Cochran.

Q. Was there any question raised regarding the acceptance of the Cochran daughters as partners in that partnership?

A. We discussed that among our family and we had known the girls, like I stated, since we were children together, knew the girls. They were girls of good character, good moral standing. In fact, I went to school with Winifred Cochran, and in view of that we certainly accepted them as partners. We were willing to accept them as partners before we signed up. [99]

Q. According to the provisions of paragraph—according to the provisions of the partnership agreement, Mr. Celli, nominally you are one of the managers, are you, as provided by paragraph 5 of that partnership agreement, now that your father has passed away? A. Yes.

Q. Have you ever exercised any of those powers provided for in that paragraph?

A. To my knowledge, those powers have never

(Testimony of Bernardo Celli, Jr.)

been exercised by either—by Dad or Mr. Cochran or myself.

Q. What was your understanding of the purpose of that device or provision of the agreement?

A. Well, primarily, one reason was that the Cochran family outnumbered the Celli family by one person in 1938, and then with the possibility of two people in 1941 when it was contemplated Don would come into the business—there was that equality we did want to maintain by having one representation from each family. Secondly, we were all young in the business. Certainly Mr. Cochran with his experience and my Dad with his experience would be better qualified to guide us in case of a dispute, and another reason was that if a decision had to be made it would be hard to assemble all nine partners and might be hard for them all to agree on one thing, so we felt it was fair to have representation from each family, and it has worked out that way. [100]

Q. Now, to your knowledge, what restrictions, if any, were there on the right of the partners, including Mrs. Johnson and Mrs. Irwin, to draw money from the business?

Mr. Nyquist: Objection, your Honor. That is covered by the partnership agreement. The instrument speaks for itself.

The Court: You say what provision was there?

Mr. Freed: What restrictions, if any, were there?

(Testimony of Bernardo Celli, Jr.)

The Court: That is covered by the agreement, is it not?

Mr. Freed: I don't think so. They can withdraw, retire from the partnership, and give notice, and withdraw all their capital and earnings at any time, but I mean drawings in the current sense. There is a schedule of drawings in——

The Court: You mean the management has the control as to what shall be withdrawn?

Mr. Freed: Was there such control over drawings, or were they free to draw as other partners were, or were the other partners restricted from their drawings; what were the restrictions, if any, not only with reference to the agreement—the agreement isn't the only thing involved here; the conduct of the parties—and from time to time they would make other agreements, other understandings of business. They don't freeze the agreement in the first place and stop right there. They modify and change and make decisions that——

The Court: As I understand your question it does not call for an answer that would be in contradiction of the language of [101] the agreement.

Mr. Freed: It might be, possibly. I am just asking the question whether there were any restrictions.

The Court: In other words, you want to know what the practice was?

Mr. Freed: That's right.

The Court: All right.

Q. (By Mr. Freed): What was the practice

(Testimony of Bernardo Celli, Jr.)

regarding drawings relating to all the partners, including Mrs. Johnson and Mrs. Irwin?

A. It was optional with the partners to draw just whatever they needed for their own use. If they needed some money to pay for life insurance or buy a home or anything else, it was their option to withdraw that money.

Q. That applied to all of the partners?

A. Absolutely.

Q. To the two daughters as well as the others?

A. Absolutely.

The Court: How did that affect the investment accounts of the partners; I mean the relative status of the investment accounts?

The Witness: Nobody took advantage of the situation, so we never were confronted with that problem.

The Court: There were withdrawals, were there not?

The Witness: Yes, but I mean there were never any large [102] withdrawals.

The Court: Did everybody withdraw in the same time, in the same year?

The Witness: No, we withdrew as we saw fit. My personal drawing account is different than anybody else's.

The Court: What disposition was made of that part of your drawing account that was not drawn?

The Witness: That was left, to remain in the business.

(Testimony of Bernardo Celli, Jr.)

The Court: And become part of the investment account of the particular partner?

The Witness: That's right.

The Court: That would soon upset the proportionate investment interest, wouldn't it?

The Witness: Yes, it could.

The Court: And did it?

The Witness: Yes, it did.

The Court: And it would affect the amount, it would affect the distribution of the profits?

The Witness: No, it didn't because the profits were to be distributed fifty per cent with the Cochran family and fifty per cent with the Celli family.

Q. (By Mr. Freed): In the families themselves there would be an effect, would there, on the distributive shares of the profits to the partners; that is, within each group, depending upon the [103] balance in the investment accounts in this certain year, is that correct?

A. I don't know if I understand your question correctly or not, but it is my understanding if a profit is made, after it goes to the Celli family and their proportionate share——

Q. It is within the family?

A. Within the family. The other fifty per cent goes to the Cochran family and their proportionate share.

The Court: The amount of the investment by each family was not determinative as to the amount of distribution?

(Testimony of Bernardo Celli, Jr.)

The Witness: No.

The Court: In other words, the Celli family, if it so desired, might withdraw all of its withdrawal accounts, the Cochran family might leave all its drawing accounts in the business and yet you would divide the profits, the net profit at the end of each year, equally between the two families?

The Witness: It could work out that way.

The Court: Then, what is the significance of capital investment?

The Witness: We were never over-capitalized, your Honor, or we were always in need of money. We have always expanded and we believe we are going to continue expanding, so we are always in need of money. We were never over-capitalized.

Q. (By Mr. Freed): Let us refer to the year 1943, the year in which this [104] business block in the heart of Oakland—is it not? A. Yes.

Q. —was purchased by Cochran and Celli. What was your need for money at that time?

A. We borrowed money to remodel the entire block. We needed money for—we were facing a problem of postwar inventories which had to be met. We needed money, like I said, to remodel the building.

Q. Did you buy that property for cash?

A. Yes, I think we did. My best recollection is that we did.

Q. By the way, when that property was acquired, was it vested in you and Sidney Cochran as trustees for the other partners?

A. Yes, it was.

(Testimony of Bernardo Celli, Jr.)

Q. Mr. Celli, I would like to show you Petitioner's Exhibit 11, which is a statement of partners' earnings for services rendered and have you explain for the record, if you can, the absence of any earnings to Lloyd J. Celli in 1943 and 1944.

A. Lloyd was in the army at that time.

Q. And no salary was paid to him during those years?

A. He received no salary.

Q. And rendered no services, is that correct?

A. That's right. [105]

Q. Did he go into the army in 1942? I notice there there is a small amount of salary, \$337.

A. To my best recollection, he went in in 1942.

Q. Yes. Now, are you familiar with the reason for no salaries to Sidney E. Cochran in 1944, according to this schedule?

A. I think that Sidney Cochran at that time was in a temporary position with the Kaiser Company.

Q. He was not working for Cochran and Celli?

A. That's right.

Mr. Freed: You may take the witness, Mr. Nyquist.

Cross-Examination

By Mr. Nyquist:

Q. Mr. Celli, you are familiar with the provisions in article 5 of the partnership agreement dated January 1, 1938; therein it is provided that the managing partners shall have the sole and exclusive power and authority to collect and distribute

(Testimony of Bernardo Celli, Jr.)

the assets and profits of said co-partnership among and between the said co-partners or any of them, and to make payment thereof for any part or portion thereof to the respective co-partners. You are aware that that provision is in the agreement, are you not? A. Yes.

Q. Now, was there any formal agreement modifying that provision? [106]

Mr. Freed: Just a moment. If your Honor please, I was listening to something else. Would you be so kind as to read back the whole question?

Mr. Nyquist: I quoted the provision in article 5 with respect to distribution of profits.

Mr. Freed: Where did you begin and where did you stop?

Mr. Nyquist: I quoted that portion of article 5 and asked whether there had been any formal agreement modifying that provision.

The Witness: I don't know if that is covered in the amendment or not. I don't know.

Q. (By Mr. Nyquist): Did a dispute ever arise between any of the managing partners and any of the other partners with respect to their rights to withdraw any profits? A. No.

Q. You testified on direct examination that it was optional with the partners to determine what they wished to withdraw. Did you base that merely upon the fact that there had been no disagreements on the matter?

A. Partly. We trusted each other, yes, and also

it is covered in the agreement that we can withdraw amounts from our capital.

Q. But with respect to distribution of earnings, the article specifically places in the managing partners the [107] authority to distribute the assets among and between said co-partners or any of them, or to make payment thereof, or any part or portion thereof to said respective co-partners.

Mr. Freed: May I interrupt at this time. I am sure counsel intended nothing unfair but I think it would be fair if the provisions of paragraph 6 which touch upon that matter should also be read to the witness.

The Court: You can bring that out on redirect.

Q. (By Mr. Nyquist): I am asking whether there was any formal agreement between the parties modifying that? A. Modifying what?

Q. Modifying that provision that I have read?

A. Not that I recall.

Q. And there was never any dispute which arose over the application of that, over the exercise of that authority by the managing partners, was there? A. No disputes, no.

Q. Then, as a matter of fact, you have no basis, have you, for the conclusion that you reached that it was optional with the partners to determine how much they would withdraw?

A. It was optional with the partners to draw what they wanted.

Q. Upon what do you base that?

A. It is covered—it is my understanding. [108]

(Testimony of Bernardo Celli, Jr.)

Q. You mean the managing partners have never exercised any rights to limit the withdrawals?

A. That is true. We have never—the managing partners have never exercised their power to limit anyone's drawings.

Q. And the drawings, by the individuals, have always been such that the managing partners have never had occasion to question the amount, is that correct?

A. That is right.

Mr. Nyquist: I have no further questions.

Redirect Examination

By Mr. Freed:

Q. Mr. Celli, I will direct your attention to the provisions of paragraph 6 of the articles of co-partnership, and I will read a portion of it to you in connection with the point that has just been raised by counsel regarding the power of the managers to prevent distribution. You will observe that in paragraph 6, after referring to the calendar year accounting provided for assessments of losses against the partners, that it is provided that: "Said managers may, if they deem it advisable, set aside a portion of, or all of any said profits as a reserve for such purpose or purposes as may be deemed advisable by them. It is understood however that nothing herein shall prevent the distribution of profits or assessment of losses more often than the interval of one year, as above specified." [109]

Now, with knowledge of that provision in the

(Testimony of Bernardo Celli, Jr.)

agreement, what is your testimony regarding the powers of the managers as provided by paragraph 5 to prevent the distribution of profits?

A. They couldn't prevent the distribution of profits. The profits had to be distributed to the two families. I don't know if I understand your question correctly.

Q. That is what I had in mind. I am referring to the provision—counsel referred to the provisions of a paragraph. I am referring to the provisions of another paragraph and your testimony fits in somewhere in between. As I understand, it was optional for the partners to draw, so far as the practice of the partners is concerned.

The Court: That refers to distribution, not to withdrawals.

Mr. Freed: Yes.

The Court: What does distribution mean when you use the term in connection with the term distribution of profits of a partnership; does it mean certain partners have distribution and others cannot? Distribution, I think, is an affirmative act by those in control of the partnership. Now, when they distribute what do they do; they distribute to all partners alike, do they not?

Mr. Freed: Yes, they do.

The Court: How does that tie in with the proposition that any particular partner can withdraw any amount he wants to, [110] either of earnings or capital without any reference whatever to a distribution?

(Testimony of Bernardo Celli, Jr.)

Mr. Freed: Well, we might ask the witness that question.

The Court: All right. Do you understand?

The Witness: Well, I think I do, your Honor. The partners can withdraw any part of their capital investment. That is, they can withdraw any part of the profits distributed at the end of the year, if I understand the question correctly.

The Court: Well, now, let us see. If a distribution is made it doesn't have to be actually paid out; it could be credited on the books and distribution would be credited on the books, we will say—distribution I am talking about.

The Witness: That's right.

The Court: In proportion to the partnership interest, the several partnership interests. Now when that account is set up to the credit of an individual partner, they can withdraw any part of that, is that what you mean?

The Witness: That's right.

The Court: Any further questions?

Mr. Freed: Yes.

Q. (By Mr. Freed): Is it your testimony, Mr. Celli, that—

Mr. Nyquist: Objection. That starts to be a leading question, "Is it your testimony [111] that—."

Q. (By Mr. Freed): What was the practice, then, let me put it that way. We have had questions relating to the agreement, and now I would like to ask a question relating to whether or not there

(Testimony of Bernardo Celli, Jr.)

were any limitations by virtue of the practice of the partners in withdrawals on the right of any partners to withdraw money from the business and charge it against that partner's account?

A. It was never a practice of any of the partners to withdraw large amounts of money. We all left our money in the business so we could use it in the business.

Q. Does that apply to all of the partners?

A. Yes.

Mr. Freed: No further questions.

Recross-Examination

By Mr. Nyquist:

Q. When Mr. Freed read to you from paragraph 6, the provision concerning—when he read the following sentence, “It is understood however that nothing herein shall prevent the distribution of profits or assessment of losses more often than the interval of one year as above specified,” did you interpret that statement that “nothing herein shall prevent the distribution of profits” as meaning that this shall require the distribution of profits at least once a year?

A. Well, I interpret that as meaning that the partners, the managing partners, would distribute the profits at least—not less than once a year, or assess any losses. [112]

Q. But provision 6 relates to distribution of profits; the statement in article 5 relates to collec-

(Testimony of Bernardo Celli, Jr.)

tion and distribution of assets or profits and payment thereof or any portion thereof to partners.

Mr. Freed: What is that?

Mr. Nyquist: The two sections, section 5 and section 6. Section 6 relates to distribution of profits among the partners, apparently an accounting procedure; section 5 relates to payment or any portion thereof to the respective partners and section 5, with respect to payments, is the section that contains the restrictions that we have mentioned, giving the managing partners the sole and exclusive authority to determine when such payments shall be made.

Q. (By Mr. Nyquist): Now, as I understand your testimony, you have said that there has been no formal agreement modifying that provision?

A. Not that I recall.

Q. And your only reason for saying that the partners had a right to withdraw whatever they wished is that no dispute has ever arisen concerning the application of that provision?

A. There never has been a dispute.

Mr. Nyquist: No further questions.

Mr. Freed: No questions.

The Court: That is all.

(Witness excused.) [113]

The Court: Any other witnesses?

Mr. Freed: That is the case.

The Court: The Petitioner rests.

Mr. Nyquist: Respondent rests, your Honor.

The Court: Both parties rest. You may have 45 days for simultaneous briefs, 30 days for answering briefs. That concludes the hearing.

Mr. Nyquist: Both of the parties would like to request a little extra time for briefs. Mr. Gebauer is going east. I am going to Salt Lake City. It would be an accommodation to both parties if we could have more time.

The Court: Sixty days for simultaneous briefs and 30 days for answering briefs.

Mr. Nyquist: Thank you.

The Court: We will adjourn until 10:00 o'clock tomorrow morning.

(Whereupon, at 3:30 o'clock p.m., the hearing in the above-entitled matter was concluded.)

Filed T.C.U.S. June 2, 1950. [114]

The Tax Court of the United States

Docket Nos. 26266, 26267

ESTATE OF MABEL COCHRAN, Deceased;
SIDNEY ELMER COCHRAN and DONALD
ROBERT COCHRAN, Executors,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

JOSEPH E. COCHRAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Upon the basis of the facts presented, held, that the members of the Cochran family did not intend to join together as partners with either of the two daughters of the petitioner, Joseph E. Cochran, and the decedent, Mabel Cochran, in the present conduct of the automobile dealership business either when the partnership was formed in 1937 or at any other time during the years 1942, 1943 and 1944.

ELI FREED, ESQ., and
EMMETT GEBAUER, ESQ.,

For the Petitioners.

CHARLES W. NYQUIST, ESQ.,

For the Respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

These cases were consolidated for hearing and decision. The respondent determined deficiencies in petitioners' income and victory tax for 1943 and income tax for 1944 as follows:

Docket

No.	Year	Deficiency
26266	1943 Estate of Mabel Cochran	\$ 9,468.67
	1944	8,005.14
26267	1943 Joseph E. Cochran	10,078.72
	1944	8,619.36

Computation of the deficiencies for 1943 involves income for both 1942 and 1943 because of the Current Tax Payment Act of 1943.

The issue presented for decision is as follows:

Did the respondent err in including in the gross income of Joseph E. Cochran and the decedent, Mabel Cochran, the distributive shares of income of the partnership, Cochran & Celli, attributable to the partnership interests of the Cochran daughters, Bernice Cochran Johnson and Winifred Cochran Irwin?

Findings of Fact

Part of the facts were stipulated and they are so found.

The two petitioners herein are the Estate of Mabel Cochran, deceased, Sidney Elmer Cochran and Donald Robert Cochran, Executors, and Joseph E. Cochran, an individual. The petitioner, Joseph

E. Cochran, resides in the State of California, as did the decedent, Mabel Cochran.

The decedent, Mabel Cochran, her husband, Joseph E. Cochran, and their daughters, Bernice Cochran Johnson and Winifred Cochran Irwin, each filed individual Federal income tax returns for each of the calendar years 1943 and 1944 with the collector of internal revenue for the first district of California. On the returns they reported gross income, income from the partnership of Cochran & Celli, net income and income tax due in the amounts shown in the following schedule:

1943

	Gross Income	Income from Partnership	Net Income	Tax Due
J. E. Cochran	\$20,777.36	\$20,777.36	\$19,756.31	\$8,822.06
Mabel Cochran	15,977.36	15,977.36	15,325.13	6,701.60
Bernice C. Johnson....	16,912.12	14,202.09	16,638.60	5,584.98
Winifred C. Irwin	15,910.30	14,202.09	15,605.32	5,481.02

1944

J. E. Cochran	\$20,370.77	\$20,370.77	\$19,832.73	\$7,467.23
Mabel Cochran	15,570.77	15,570.77	15,039.85	4,949.93
Bernice C. Johnson..	16,259.16	13,840.71	15,759.16	4,839.58
Winifred C. Irwin	15,551.95	13,840.70	15,051.95	4,955.98

The "Tax Due" in the above schedule for the year 1943 includes the unforgiven part of the 1942 tax. The "Income from Partnership" for the year 1944 includes a small amount of capital gain (\$318.30 or less) in each case.

For a number of years prior to 1938, the petitioner, Joseph E. Cochran, and one Bernardo Celli, Sr., owned and operated as copartners a Chevrolet automobile dealership in Oakland, California, under the firm name of "Cochran & Celli."

In 1937 the two adult sons of the Cellis, Lloyd and Bernardo, Jr., were employed in the business, as was Sidney Cochran, the adult Cochran son. The Cellis had no other children, but in the Cochran family, besides Sidney, there were two adult daughters, Bernice and Winifred, and a minor son, Donald, who was approximately 17 years of age at that time (1937).

In order to perpetuate the Chevrolet franchise in their families and to interest their sons in staying in the business, the two partners decided in 1937 to take their sons into the business as copartners.

Under the new partnership agreement, dated January 1, 1938, not only the sons, but also Mabel Cochran, the wife of Joseph E. Cochran, Anna Celli, the wife of Bernardo Celli, Sr., and the Cochran daughters, Bernice and Winifred, were to be copartners in the business. The two Cochran daughters were included because their father felt morally obligated to give them as much as he gave his sons. There was also an understanding among the families that Donald Cochran was to become a partner when he reached his majority.

Under the new partnership agreement no additional capital was at any time invested in the business by any of the copartners. The source of the capital investments of the new copartners, who were members of the Cochran family, were withdrawals from the Joseph E. Cochran investment account. Such transfers were at all times treated by Joseph E. Cochran as gifts of interest in the business and

in making them he took advantage of the community property laws of the State of California by first crediting his wife's new investment account with a substantial part of the withdrawal from his account, and then spreading out over a period of years the transfers to the Cochran children of portions of his own and his wife's investments in the business, so that he and his wife filed gift tax returns for the year 1937 only and reported no gift tax due. When Donald Cochran was brought into the business as a copartner in 1941, his capital investment account was similarly set up as a result of transfers of capital from the accounts of his parents, brother and sisters in accordance with a verbal understanding existing at the time Sidney, Bernice and Winifred acquired their interests in the business.

The withdrawals from the Joseph E. Cochran investment account, the credits to his wife's new investment account, the crediting of new investment accounts of the Cochran daughters, Bernice and Winifred, and their signing of the partnership agreement all took place within the months of November and December, 1937, and were all component parts of a single plan to make all members of the Cochran family copartners in the business.

The new partnership was managed by the two original partners, assisted by their sons. The Cochran daughters neither shared in the management or control of the new partnership, nor did they render

any services to the business. In 1942, 1943 and 1944 both daughters made regular withdrawals of money from the accumulated profits of the partnership credited to their accounts.

There was no bona fide intent on the part of the copartners of Cochran & Celli and the two Cochran daughters, Bernice and Winifred, either when the partnership was formed or at any other time during the taxable years 1942, 1943 and 1944, that the two Cochran daughters were to be joined with members of the existing partnership of Cochran & Celli for the purpose of carrying on business as a partnership. Bernice Cochran Johnson and Winifred Cochran Irwin were not valid partners for income tax purposes in the business of Cochran & Celli during the years 1942, 1943 and 1944.

Opinion

Hill, Judge: The sole issue presented for decision herein is whether the respondent erred by including in petitioners' gross income the distributive shares of income of the partnership, Cochran & Celli, attributable to the partnership interests of the two Cochran daughters, Bernice and Winifred. This issue raises a question of fact whether there was a bona fide intent on the part of the partners in the business known as Cochran & Celli and the two Cochran daughters that the two Cochran daughters really and truly were to be joined as partners in the business. *Commissioner v. Culbertson*, 337 U. S. 733. The burden of proof in this respect rests upon

the petitioners under Rule 32 of the Rules of Practice.

The evidence presented by the petitioners shows that in the years 1942, 1943, and 1944, the Cochran daughters, Bernice and Winifred, each withdrew for their own personal use profits from the business of Cochran & Celli. On the other hand the evidence also showed that neither of them performed any services for the new partnership and their testimony failed to establish the fact that they had any voice in the management and control of the business. Furthermore, their investments of capital in the business did not originate with them but with their parents. Petitioner Joseph E. Cochran testified that the reason he made his daughters partners in the business was to afford them treatment equal to that he had shown his sons. While his motive was commendable, the fact remains the evidence fails to show the existence of any business purpose for bringing either of the two daughters into the partnership or that there was a bona fide intent that the two daughters be joined as partners in the business in question.

From a consideration of the entire record, we believe and hold that petitioners have failed to meet the burden of proving the reality of the partnership insofar as the Cochran daughters are concerned.

Accordingly, we hold that the respondent did not err in including in petitioners' gross income for 1942, 1943, and 1944, the distributive shares of income of the partnership, Cochran & Celli, attrib-

utable to the alleged partnership interest of Bernice Cochran Johnson and Winifred Cochran Irwin.

Decisions will be entered for the respondent.

Entered July 12, 1951.

Received July 9, 1951.

Served July 16, 1951.

The Tax Court of the United States
Washington

Docket No. 26266

Estate of MABEL COCHRAN, Deceased; SID-
NEY ELMER COCHRAN and DONALD
ROBERT COCHRAN, Executors,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Memorandum Findings of Fact and Opinion, entered July 12, 1951, it is

Ordered and Decided: That there are deficiencies in income and victory tax for the year 1943, in the amount of \$9,468.67, and income tax for the year 1944, in the amount of \$8,005.14.

/s/ EUGENE BLACK,
Judge.

Entered July 16, 1951.

Served July 18, 1951.

The Tax Court of the United States
Washington

Docket No. 26267

JOSEPH E. COCHRAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Memorandum Findings of Fact and Opinion, entered July 12, 1951, it is

Ordered and Decided: That there are deficiencies in income and victory tax for the year 1943, in the amount of \$10,078.72, and in income tax for the year 1944, in the amount of \$8,619.36.

/s/ EUGENE BLACK,
Judge.

Entered July 16, 1951.

Served July 18, 1951.

In the United States Court of Appeals
for the Ninth Circuit

Tax Court Docket No. 26266

Estate of MABEL COCHRAN, Deceased; SID-
NEY ELMER COCHRAN and DONALD
ROBERT COCHRAN, Executors,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Tax Court Docket No. 26267

JOSEPH E. COCHRAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REVIEW

Taxpayers, petitioners in this cause, by Eli Freed, Emmett Gebauer, and Scott Fleming, counsel, hereby file their petition for a review by the United States Court of Appeals for the Ninth Circuit of the decisions by the Tax Court of the United States, promulgated July 12, 1951, 10 T.C.M. 675, determining deficiencies in said petitioners' federal income and victory taxes for the calendar year 1943, and income taxes for the calendar year 1944, as follows:

Estate of Mabel Cochran, Deceased:

1943 income and victory taxes	.\$ 9,468.67
1944 income taxes	8,005.14

Joseph E. Cochran:

1943 income and victory taxes..	10,078.72
1944 income taxes	8,619.36

The decision determining said deficiencies was rendered and entered July 16, 1951, after hearing by the Tax Court of the United States in San Francisco, California.

Petitioners respectfully show:

I.

That Petitioner Estate of Mabel Cochran, Deceased, is the estate of a decedent; that said estate is being probated in the County of Alameda, State of California; that Sidney Elmer Cochran and Donald Robert Cochran are the duly appointed, qualified, and acting executors of said estate.

That petitioner, Joseph E. Cochran, is an individual residing in Orinda, Contra Costa County, California.

II.

This petition for review is properly directed to the United States Court of Appeals for the Ninth Circuit in accordance with the provisions of the Internal Revenue Code, Section 1141(b)(1), in that the tax returns with respect to which the asserted liabilities arise were made to the Office of the Collector of Internal Revenue for the First District of California.

III.

Nature of the Controversy

The controversy involves the proper determination of the petitioners' federal income and victory tax liability for the calendar year 1943, and income tax liability for the calendar year 1944.

For a number of years prior to December 31, 1937, petitioner Joseph E. Cochran and Bernardo Celli, Sr., now deceased, owned and operated as co-partners a Chevrolet automobile dealership business in Oakland, California, under the firm name "Cochran & Celli." On or about January 1, 1938, the said Bernardo Celli, Sr., Joseph E. Cochran, petitioner herein, and Mabel Cochran, his wife, since deceased, whose estate is a petitioner herein, and certain other persons, including Bernice M. Cochran and Winifred Cochran, adult daughters of the said Joseph E. Cochran and Mabel Cochran, entered into a partnership for the transaction of the aforesaid Chevrolet automobile dealership business; and at all times from its organization through the calendar years 1943 and 1944 involved in this proceeding said business was conducted as a partnership.

The petitioners contend that said partnership was organized and conducted in good faith and that it was intended to be and was a real, true, and bona fide partnership during the calendar years 1943 and 1944, and that said partnership is entitled to full recognition for federal income and victory tax purposes for such years.

Respondent contends that, insofar as Bernice

Cochran Johnson, formerly the said Bernice M. Cochran, and Winifred Cochran Irwin, formerly the said Winifred Cochran, are concerned, said partnership was not a real, true, and bona fide partnership during the calendar years 1943 and 1944 and is not entitled to recognition for federal income and victory tax purposes for such years; and respondent asserted tax deficiencies for the calendar years 1943 and 1944 on the ground that said Bernice Cochran Johnson and Winifred Cochran Irwin were not then bona fide and valid partners for federal income and victory tax purposes.

IV.

The aforesaid assertion of tax deficiencies was sustained by the Tax Court of the United States; and petitioners, being aggrieved by the findings of fact and opinion of said court and by its decision entered pursuant thereto, desire to obtain a review thereof by the United States Court of Appeals for the Ninth Circuit.

Dated: October 3, 1951.

/s/ ELI FREED,

/s/ EMMETT GEBAUER,

/s/ SCOTT FLEMING,

1069 Mills Building, San Francisco 4, California,
Counsel for Petitioners.

Received and filed T.C.U.S. October 8, 1951.

[Title of Tax Court and Causes.]

CERTIFICATE

I, Ralph A. Starnes, Chief Deputy Clerk of The Tax Court of the United States do hereby certify that the foregoing documents, 1 to 28, inclusive, constitute and are all of the original papers and proceedings, including Petitioner's Exhibits 23 to 26, inclusive, admitted in evidence, on file in my office as the original and complete record in the proceedings before The Tax Court of the United States in the above-entitled proceedings and in which the petitioners in The Tax Court proceedings have initiated an appeal as above-numbered and entitled, together with a true copy of the docket entries in said Tax Court proceedings, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 25th day of October, 1951.

[Seal] /s/ RALPH A. STARNES,
Chief Deputy Clerk The Tax Court of the United
States.

[Endorsed]: No. 13147. United States Court of Appeals for the Ninth Circuit. Estate of Mabel Cochran, Deceased; Sidney Elmer Cochran and Donald Robert Cochran, Executors, and Joseph E. Cochran, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of Record. Petition to Review a Decision of The Tax Court of the United States.

Filed November 1, 1951.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 13147

ESTATE OF MABEL COCHRAN, Deceased;
SIDNEY ELMER COCHRAN and DONALD
ROBERT COCHRAN, Executors,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

JOSEPH E. COCHRAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

POINTS ON WHICH PETITIONERS
INTEND TO RELY

As and for points on which petitioners intend to rely in the prosecution of this appeal, petitioners assert that the decisions of the Tax Court herein were pervaded by the general errors of fact and law set forth under I below, by reason of which said court made the particular legal and factual errors set forth under II below.

I.

General Nature and Basis of Errors

The decisions of the Tax Court in the above-

entitled matters are infected throughout by the failure of said court to adhere to and apply the "bona fide intent" rule laid down by the controlling authorities and particularly exemplified by the opinion of the United States Supreme Court in the case of Commissioner of Internal Revenue vs. Culbertson (1949), 337 U.S. 733. Petitioners submit that the Tax Court, while purporting to observe applicable and established principles set forth in the Culbertson decision and other leading authorities in this field of law, actually ignored such principles and followed instead the supposed rules, repudiated in the Culbertson decision, purporting to require either the contribution of "original capital" or "vital services."

By reason of the Tax Court's failure to appreciate, observe, and apply the "bona fide intent" test, it failed properly to consider circumstances surrounding the partnership here involved, as shown by the facts stipulated, the exhibits, and the testimony, for the light that such circumstances shed on the dominant question of bona fide intent to do business as partners. The Tax Court erroneously failed to appreciate the relevancy of and give proper weight to the evidence submitted by petitioners, and by reason of such failure it erroneously concluded that petitioners had not met the burden of proof necessary to establish such "bona fide intent" to establish and conduct the business involved as real and true partners.

Had the Tax Court properly observed and applied sound principles of family partnership law as laid

down in the Culbertson case and other leading authorities, it would necessarily have made findings and reached conclusions, on the basis of the record herein, substantially in accordance with those set forth under II, below. From such findings and conclusions necessarily required by the facts stipulated and evidence introduced, decisions in favor of the petitioners would necessarily follow as a matter of law.

II.

Particular Errors Committed by the Tax Court

1. As a result of the fundamental, underlying, erroneous view and application of the law as above set forth, the Tax Court erred in failing to make the following findings which were proposed by the petitioners and which are included in the printed record prepared herein under the heading "Statement of Facts Based on Evidence" and constituting a portion of document No. 15 of the official record. Although petitioners submit that all of their proposed findings were and are required by the evidence and should have been made, petitioners particularly assert error in the failure of the Tax Court to make findings Nos. 7, 14, 27, 28, 32, 36, 40, 44, 45, 46, 51, 52, 53, 54, 57, 58, 60, 61, 63, 64, 65, 71, 72, 73, 74, 76, 81, 82, or findings substantially in accordance therewith.

2. The evidence required the Tax Court to conclude, and said Court erred in not concluding:

(a) That petitioners each made bona fide and completed gifts of capital interests in the business of Cochran & Celli to Bernice Cochran Johnson and

Winifred Cochran Irwin on or about December 24, 1937. That at all times thereafter and throughout the calendar years 1942, 1943 and 1944 said capital interests have in fact been owned by said donees, Bernice Cochran Johnson and Winifred Cochran Irwin.

(b) The ownership, dominion, and control of said business interests by said donees were restricted only by the express provisions of the partnership agreement. The restrictions imposed by said partnership agreement with respect to the interests of Bernice Cochran Johnson and Winifred Cochran Irwin were exactly the same as in the case of the Cochran and Celli sons who have been recognized as valid partners, and necessarily so. Said restrictions served and promoted valid partnership business purposes, were reasonable in nature, and were entirely consistent with the completeness of the original gifts and the reality of the donees' actual and bona fide ownership of the interests given them.

(c) That said Bernice Cochran Johnson and Winifred Cochran Irwin were in all respects treated the same as the other donees, the various sons in the Cochran and Celli families who were recognized as valid partners for income tax purposes, with this one exception: Said sons, during the times when they rendered personal services to the business, were paid salaries as reasonable compensation on account of such personal services. These salaries were in addition to partnership shares of business profits based on ownership of partnership interests in the business. With respect

to partnership shares of profits of the business, Bernice Cochran Johnson and Winifred Cochran Irwin were at all times and in all ways treated the same as all other partners.

(d) At all times from and after the making of the aforesaid completed gifts and the formation of the partnership, Bernice Cochran Johnson and Winifred Cochran Irwin actually owned and were entitled to draw their respective shares of profits from the partnership business for their own separate use to the same extent as any other partners having similar capital interests; said Bernice Cochran Johnson and Winifred Cochran Irwin did draw substantial sums from the business during the taxable years 1942, 1943 and 1944 for their own separate use.

(e) At all times from and after the making of the aforesaid completed gifts and the formation of the partnership, Bernice Cochran Johnson and Winifred Cochran Irwin each had extensive and real control and dominion over her capital investment in the partnership in that each had the right to withdraw from the partnership, or cause a dissolution of the partnership and receive her share of the partnership capital for her own separate use and benefit, in accordance with the provisions of paragraphs 12 and 13 and related provisions of the partnership agreement.

(f) At all times from and after the formation of the partnership, commencing January 1, 1938, and including the years 1942, 1943 and 1944, property was a very significant income-producing factor in the partnership business, and the capital interests

of Bernice Cochran Johnson and Winifred Cochran Irwin and beneficial interests in partnership real property owned by each of them were important in the successful operation of the business.

(g) The partnership, formed at the end of 1937 to commence business at the beginning of 1938, was formed as a result of a bona fide and arms' length transaction between the unrelated families of Cochran and Celli.

(h) That said gifts and the formation of the partnership here in question were motivated solely by the intent to make bona fide gifts of interests in the business to all members of petitioners' family and were not motivated or influenced by income tax considerations.

(i) Bernice Cochran Johnson and Winifred Cochran Irwin should not be differentiated or discriminated against on account of their sex.

3. The law and the evidence required the Tax Court to conclude and said court erred in not concluding that in 1937 when the partnership was organized, in 1938 when it commenced business, and at all times thereafter and throughout the taxable years 1942, 1943 and 1944 Bernice Cochran Johnson and Winifred Cochran Irwin and all other existing partners of Cochran and Celli actually and in good faith intended to and did in fact join together in the present conduct of the business as partners, and said Bernice Cochran Johnson and Winifred Cochran Irwin were valid and bona fide partners for income tax purposes from the beginning of 1938 to and throughout the taxable years 1942, 1943 and 1944.

4. The decisions of the Tax Court are not supported by the evidence and are contrary to the evidence.

5. The decisions of the Tax Court rest on errors of law and are contrary to law.

6. The Tax Court erred in making the following findings of fact:

“There was no bona fide intent on the part of the copartners of Cochran & Celli and the two Cochran daughters, Bernice and Winifred, either when the partnership was formed or at any other time during the taxable years 1942, 1943 and 1944, that the two Cochran daughters were to be joined with members of the existing partnership of Cochran & Celli for the purpose of carrying on business as a partnership. Bernice Cochran Johnson and Winifred Cochran Irwin were not valid partners for income tax purposes in the business of Cochran & Celli during the years 1942, 1943 and 1944.”

7. The Tax Court erred in determining deficiencies against the petitioners instead of determining that there were no tax deficiencies with respect to petitioners' income for the calendar years 1942, 1943 and 1944.

Dated November 30, 1951.

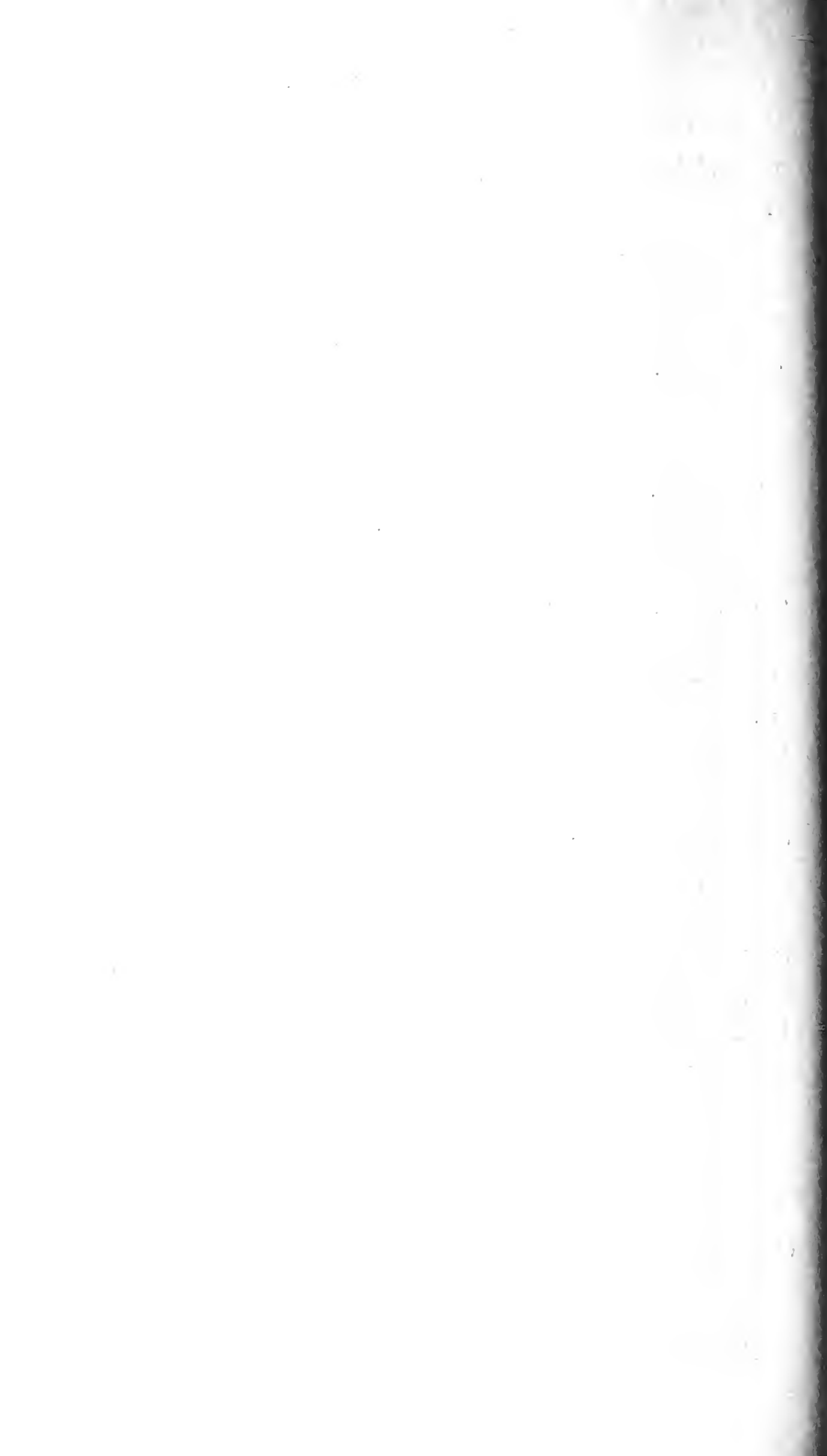
/s/ ELI FREED,

/s/ EMMETT GEBAUER,

/s/ SCOTT FLEMING,

Counsel for Petitioners, 1069 Mills Building, San Francisco 4, California.

[Endorsed]: Filed U.S.C.A. December 1, 1951.



No. 13,147

IN THE

United States Court of Appeals
For the Ninth Circuit

ESTATE OF MABEL COCHRAN, Deceased;
SIDNEY ELMER COCHRAN and DONALD
ROBERT COCHRAN, Executors, and
JOSEPH E. COCHRAN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONERS' OPENING BRIEF.

ELI FREED,

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1069 Mills Building, San Francisco 4, California,

Attorneys for Petitioners.

FILED

APR - 4 1952

PAUL P. O'BRIEN

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No. 13,147

IN THE

**United States Court of Appeals
For the Ninth Circuit**

ESTATE OF MABEL COCHRAN, Deceased;
SIDNEY ELMER COCHRAN and DONALD
ROBERT COCHRAN, Executors, and
JOSEPH E. COCHRAN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONERS' OPENING BRIEF.

STATEMENT OF THE CASE.

This is a petition to review a decision of the Tax Court denying the validity of a family partnership as between petitioner Joseph E. Cochran and Mabel Cochran, his wife, deceased, and their two grown daughters Bernice Cochran (Johnson) and Winifred Cochran (Irwin). The taxable years involved are 1942 and 1943 and 1944.

There is no dispute as to the evidentiary facts. In the depression years 1936 and 1937, nine members of the Cochran family and the Celli family (the two families are unrelated to each other), all adults, had

discussions, negotiated and came to an agreement to form a partnership, to take over and own and operate the Chevrolet automobile dealership of Cochran & Celli in Oakland, California, a business which was operated as a partnership by the two families since 1915. (R. 95, 96.) From 1906 to 1915 the business was known as the City Front Wagon Works. (R. 94, 95.) In previous years the partners were the heads of the families, Joseph E. Cochran and Bernardo Celli, who were equal partners; and their interests were community property. Joseph E. Cochran and Mabel Cochran, his wife, had four children, two daughters and two sons; Bernardo Celli and Anna Celli, his wife, had two children, both sons. In 1936 and 1937 Bernardo Celli Jr. also called Ben Celli, and Lloyd Celli, the Celli sons, were working in the business. Ben Celli was the salesmanager. (R. 97.) Sidney E. Cochran, the older son of Joseph E. Cochran and Mabel Cochran was assistant salesmanager. (R. 97.) Donald R. Cochran was seventeen years of age and was going to school. Bernice Cochran Johnson and Winifred Cochran Irwin, the daughters, were the eldest children; they were teaching in high schools. Cochran & Celli had been established for many years and the daughters had worked in the business during school vacations, after school and on Saturdays. The business was a very important part of the background in the lives of the parents and children of both families. The parents believed that bringing the children into the business as partners would give them the incentive of ownership and keep them in the business; and in case of death of the elders, the children

would be able to retain the Chevrolet franchise and continue the business. (R. 99.) After many conversations and discussions among all the members of both families, in the latter part of 1936 and during 1937, in November and December of 1937 an attorney was consulted regarding the agreement of the members of both families to organize a partnership of all the members of both families (except Donald Cochran) to take over the business of Cochran & Celli. (R. 100.) A comprehensive partnership agreement was finally completed by the attorney. It was dated the 1st day of January 1938, and signed by all of the parents and children, except Donald R. Cochran. However, paragraph 4 of the agreement contemplated that Donald R. Cochran could be admitted as a partner when he became twenty-one years old and if he agreed to the terms and conditions of the partnership contract. (See Ex. No. 7, R. 39.) A certificate signed by all partners certifying that they were doing business as partners under the name of Cochran & Celli was filed in the office of the County Clerk.

In conceiving and organizing the partnership, there was no thought or consideration given to income taxes. In 1936 and 1937 profits were not very high and tax rates were low; income taxes were nominal. (R. 105, 118.) There was definitely no idea of income tax avoidance.

The investments of capital in the partnership by the children in both families, including the daughters, came from gifts of capital by their parents. Each of

the Cochran children (except Donald) acquired a 7% interest in the capital and each of the Celli children acquired a 10% interest in the capital. The respective capital investment of each partner determined the percentage of interest. The total capital in the business invested by both families, January 1, 1938, was \$480,520.38 and the capital accounts of each of the partners on that day shown on the books by the closing balances December 31, 1937, were as follows:

J. E. Cochran	\$91,842.88
Mabel Cochran	50,162.80
Sidney E. Cochran	33,636.42
Bernice E. Johnson	33,636.42
Winifred Irwin	33,636.42
Bernardo Celli, Sr.	87,528.52
Anna Celli	53,972.84
Bernardo Celli, Jr.	48,052.04
Lloyd J. Celli	48,052.04
(Ex. No. 10, R. 60.)	

A written amendment to the agreement was made February 28, 1945, signed also by Donald R. Cochran (Ex. 8, R. 43), in which it was recognized that Donald R. Cochran was admitted in 1941. This amended agreement set forth the percentages of interests in the partnership of all of the partners shown on the books beginning 1938 to and including the time of the amended agreement. There was very little change in the percentages of interests of Sidney, Winifred and Bernice Cochran through the years 1938, 1939, 1940, 1941 and 1942 and there were no other gifts of partnership interests from J. E. Cochran and Mabel Cochran to their children until 1941 when they each

made a gift of \$4,000.00 to Donald R. Cochran; again in 1942 they made gifts of \$4,000.00 to each of their children, and in 1943 and 1944 they made gifts of \$3,000.00 to each of their children. (Exs. No. 1 and No. 2, R. pp. 24 and 25.)

The partnership agreement provided for substantial capital contributions to the partnership by each of the partners and the agreement expressly provided that each partner was the owner of the portion of the business based on the percentage of capital of each partner. The percentage of capital determined the percentage of partnership profits of each partner. The agreement carefully provided for principal management of the business by J. E. Cochran and Bernardo Celli; however, in the event of the death of one of them, the management duties were to be taken over by his oldest surviving son. (Paragraphs 5 and 9.) The term of the partnership was one year, subject to its continuation from year to year thereafter if thirty days' notice in writing were not given by any one of the partners indicating a desire to dissolve the partnership. (Paragraph 12.) Withdrawal from the partnership was permitted as a matter of right and in case of retirement of any one of the partners, the partnership was to be dissolved and the book value of the withdrawing partner's interest was to be paid to such partner over a period of five years, 10% within sixty days after the effective date of retirement and the balance in installments of not less than one-fifth each year thereafter; the balance was subject to payment of interest of 5% per annum. (Paragraph 13.)

The agreement further provided that the real property in the partnership which was substantial, was to be transferred to the two oldest sons of the Cochran and Celli families and held in trust by them for the benefit of the partnership. This was done. (Paragraph 24, Ex. No. 7, R. 42 and Ex. No. 9, R. 52.)

The capital accounts of all of the children, including Bernice Cochran and Winifred Cochran, were very substantial each year, beginning with 1938; the distributive net profits of the partnership were credited to each partner's capital account each year. (Ex. No. 10, R. 60.) The total capital used in the business each year commencing with 1938 through 1944 was large. The assets in the business ranged from about \$750,000.00 in 1938, to about \$1,265,000.00 in 1944. The real property and equipment for each year including 1942 and 1943 and 1944, which are the years directly involved herein, averaged 60%, more or less, of the total capital of the partners. The other assets such as cash, receivables and inventories (less a small percentage of liabilities) accounted for the remainder of the capital. (Exs. No. 15, 16, 17, 18, 19, 20, 21, R. pp. 62-75.)

The services of the partners who worked in the business were compensated for by payment of salaries which were subtracted from the partnership income to arrive at net profits distributable to the partners. (Ex. No. 11, R. 60.) Bernice Cochran and Winifred Cochran who did not work in the business received no salaries and their profits from the business were limited to a return on their capital investments. Each

partner, including Bernice and Winifred Cochran, had the right to withdraw money from the business and they made withdrawals within reason, particularly within the years in issue. (R. 110, 174.) The business had a great need for capital. It was not until after the war just ended that the business was able to pay cash for its purchases of cars. (R. 112.)

Although the partnership agreement (Par. 5, R. 31) carefully provided for management control by J. E. Cochran and Bernardo Celli, actually the business was managed with the assistance of the sons who were department heads. The provision for management control was not for the personal advantage of the parents; its purpose was to provide for easy settlement of any disputes among the partners and to give each family an equal voice in the business since the greater number of partners was on the Cochran side. (R. 150, 163, 172.)

In 1937, Bernice Cochran was twenty-seven years old (R. 146) and Winifred Cochran was twenty-five years old. (R. 160.) They had graduated from the University of California and both had B.A. and M.A. degrees. They had a background of having worked in Cochran & Celli on Saturdays, after school and during school vacations. (R. 170.) Before signing the partnership agreement of January 1, 1938, they discussed and understood its provisions. Bernice Cochran was about to get married and she weighed carefully whether to sign the agreement in view of the legal liability involved. (R. 149.) She talked it over with her husband-to-be before coming to a decision. Bernice Cochran testi-

fied that her contribution to the business was equal to the others to the extent of her capital investment which was "earning capital" for the business and also since she left her profits in the business "to build the business up to its present size". She regarded her investment in the business as a good, sound investment. (R. 157.) It was Winifred Cochran's understanding (R. 167, 168) that she and her sister could if they wished have elected to work in the business for salaries or that they could elect not to work and receive only their share of profits based on their percentage of capital.

Bernice and Winifred Cochran received at least once each year financial reports of the business showing the annual net profits of the business, their shares their drawings, and all of the capital accounts including their own. (R. 151.) (See Exs. Nos. 10, 11 and 12, R. 60.) The daughters were aware of and recognized from the beginning that they had the right as provided in the partnership agreement to retire from the partnership on notice and withdraw their entire investments. (R. 151, 152.) They both showed a great interest in the progress of the business. They kept informed about the increase in their investments from financial statements and discussions with partners. (R. 168.) Whenever a new piece of property was to be purchased, they knew about it ahead of time (R. 164, 168), its location, its purpose and so on. In 1942 or 1943 before Cochran & Celli bought the location of its main place of business for \$200,000.00 (R. 112, 113), Winifred Cochran investigated the property. She

looked at the property and discussed it with the other partners in her family.

In July 1948, a corporation was organized and Bernice and Winifred Cochran and the other partners received shares of capital stock for their shares of net worth in the partnership. (R. 155, 167.)

The members of the Celli family, who were entirely unrelated to the Cochrans, after due deliberation, accepted both Bernice and Winifred Cochran in the business as binding partners and signed the partnership agreement to such effect. (R. 171.)

SPECIFICATION OF ERRORS.

The Tax Court was clearly in error in finding that:

1. There was no bona fide intent on the part of the copartners of Cochran & Celli and the two Cochran daughters, Bernice and Winifred, either when the partnership was formed or at any other time during the taxable years 1942, 1943 and 1944, that the two Cochran daughters were to be joined with members of the existing partnership of Cochran & Celli for the purpose of carrying on business as a partnership; and
2. Bernice Cochran Johnson and Winifred Cochran Irwin were not valid partners for income tax purposes in the business of Cochran & Celli during the years 1942, 1943 and 1944. (R. 191.)

ARGUMENT.

Counsel have struggled long and hard to comprehend how the Tax Court could have read the record in this case and have failed so completely to recognize the Cochran & Celli partnership business as the old-time traditional family business which has done so much to build up the strong family economic backbone of our country; and that for years and years daughters as well as sons have been given partnership interests in such businesses, interests which are not sham and colorable, but interests which are as real as those of sons and which have been honorably recognized and adhered to.

There just is no factual support for the Tax Court's ultimate findings that there was no bona fide intent on the part of the copartners of Cochran & Celli to accept Bernice and Winifred Cochran as members of the partnership of Cochran & Celli for the purpose of carrying on business as a partnership, and that Bernice and Winifred were not true partners during the years 1942, 1943 and 1944. The premise upon which such ultimate findings is predicated is that their investments of capital in the business originated with their parents, that neither of them performed any services for the new partnership, and that they did not share in the management or control of the partnership. As a matter of income tax law this premise as a predicate for said findings of the Tax Court clearly and erroneously ignores other significant realistic factors existing in the Cochran & Celli

partnership, particularly the importance of capital and the business purpose which it serves, as the chief income producing factor in the business. The findings of fact of the Tax Court, while presumptively correct, are not conclusive on review. (*Walsh v. Commissioner*, 8 Cir., 170 F. (2d) 535, 539; *Stanchfield v. Commissioner*, 8 Cir., 191 F. (2d) 826, 828.)

Whether for federal income tax purposes a partnership exists is a question of fact to be determined, as any other fact, from all the evidence, including the partnership agreement and the conduct of the parties in the execution of its provisions, and if upon a consideration of all the facts it is found that the partners joined together in good faith to conduct the business, having honestly agreed that the services or capital to be contributed presently by each is of such value to the partnership that the contributors should in every respect participate in the distribution of the profits, that is sufficient for the recognition of a partnership for federal income tax purposes. (*Commissioner v. Culbertson*, 337 U.S. 733, 734, 735, 69 S. Ct. 1210, 1215, 93 L. Ed. 1659, 37 A.F.T.R. 1210; *Stanchfield v. Commissioner*, supra; *Greenberger v. Commissioner*, 7 Cir., 177 F. (2d) 990, 994.) That is clearly the case in *Cochran & Celli*.

Petitioners believe that the Tax Court erroneously made its determination that no valid family partnership existed with respect to the two Cochran daughters by a strict application of the "vital services-original capital" test laid down in the *husband* and

wife partnership cases of *Commissioner of Internal Revenue v. Tower*, 327 U.S. 280, 66 S. Ct. 532, 90 L. Ed. 670, 164 A.L.R. 1135; *Lusthaus v. Commissioner*, 327 U.S. 293, 66 S. Ct. 539, 90 L. Ed. 679.

What the United States Supreme Court said in those cases regarding the absence of facts meeting such tests must be considered in connection with the particular facts of those cases. In *Greenberger v. Commissioner of Internal Revenue*, 177 F. (2d) 990, 992, the court made the following observations with respect to said cases:

“* * * The controlling factor in those decisions, so it seems to us, is that the Tax Court had found that there was no real partnership and no intent to carry on a business as such, and there runs through the *Tower* and *Lusthaus* decisions, especially the former, the thought that the partnership device was resorted to as a sham for the purpose of evading income taxes. For instance, in the *Tower* case the alleged gift from the husband to the wife was made three days before the partnership was formed, and it was only a book transaction. There was no real transfer of property to her over which she exercised dominion or control. The wife used the income, 327 U.S. at page 291, 66 S.Ct. at page 538: ‘only for purposes of buying and paying for the type of things she had bought for herself, home and family before the partnership was formed.’ This led to the observation, 327 U.S. at page 292, 66 S.Ct. at page 538, ‘Consequently the result of the partnership was a mere paper reallocation of income among the family members. The actualities

of their relation to the income did not change.' A similar situation is disclosed in the *Lusthaus* case. The court stated, 327 U.S. at page 296, 66 S.Ct. at page 540: 'His wife was not permitted to draw checks on the business bank account. * * * Neither partner could sell or assign the interest ascribed by the partnership agreement without the other's written consent. * * * no withdrawals were to be made under the partnership agreement unless both partners agreed.' "

The *Tower* and *Lusthaus* cases involved tax avoidance schemes; they were obviously not bona fide and there was clearly no good faith intent to have a business partnership.

The United States Supreme Court granted certiorari in *Commissioner of Internal Revenue v. Culbertson*, supra, because it was clearly necessary to give further consideration to the family partnership problem. The *Culbertson* case originated in the Tax Court of the United States and the Tax Court erroneously focused its attention entirely on the concepts of "vital services and original capital" and simply decided that the alleged partners had not satisfied those tests when the facts were compared with those in the *Tower* case. The Supreme Court recognized that an absence of vital services and participation in management and control of the business or original capital are important factors to be considered in determining whether there was a bona fide intent of the parties to join together as partners. The court said, however,

“* * * But such a determination is not conclusive, and that is the vice in the ‘tests’ adopted by the Tax Court. It assumes that there is no room for an honest difference of opinion as to whether the services or capital furnished by the alleged partner are of sufficient importance to justify his inclusion in the partnership. If, upon a consideration of all the facts, it is found that the partners joined together in good faith to conduct a business, having agreed that the services or capital to be contributed presently by each is of such value to the partnership that the contributor should participate in the distribution of profits, that is sufficient. The Tower case did not purport to authorize the Tax Court to substitute its judgment for that of the parties; it simply furnished some guides to the determination of their true intent.” (337 U.S. 733, 744-745, 69 S. Ct, 1210, 1215.)

On the subject of the importance attached to the factor of “original capital,” the court addressed itself as follows:

“The Tax Court’s isolation of ‘original capital’ as an essential of membership in a family partnership also indicates an erroneous reading of the Tower opinion. We did not say that the donee of an intra-family gift could never become a partner through investment of the capital in the family partnership, any more than we said that all family trusts are invalid for tax purposes in *Helvering v. Clifford*, *supra*. The facts may indicate, on the contrary, that the amount thus contributed and the income therefrom should be

considered the property of the donee for tax, as well as general law, purposes. In the Tower and Lusthaus cases this Court, applying the principles of *Lucas v. Earl*, *supra*; *Helvering v. Clifford*, *supra*; and *Helvering v. Horst*, *supra*; 311 U.S. 112, 61 S.Ct. 144, 85 L.Ed. 75, 131 A.L.R. 655, found that the purported gift, whether or not technically complete, had made no substantial change in the economic relation of members of the family to the income. In each case the husband continued to manage and control the business as before, and income from the property given to the wife and invested by her in the partnership continued to be used in the business or expended for family purposes. We characterized the results of the transactions entered into between husband and wife as 'a mere paper reallocation among the family members,' noting that 'The actualities of their relation to the income did not change.' This, we thought, provided ample grounds for the finding that no true partnership was intended; that the husband was still the true earner of the income."

It is quite evident that the Tax Court decided that Bernice Cochran and Winifred Cochran were not valid partners for income tax purposes in Cochran & Celli for 1942, 1943 and 1944 because they did not perform any services for the partnership or participate in the management and control of the business, and because their investments of capital in the business did not originate with them but came from their parents. (R. 192.) A careful reading of the Tax Court's opinion below leaves no doubt that the so-

called *Tower* and *Lusthaus* tests were applied to the Cochran & Celli family partnership despite *Culbertson* and there should be no question whatsoever that the factual situations are entirely different. It is submitted that a finding that there was no bona fide intent to form and do business as partnership by the application of the vital services and original capital tests, without proper consideration of the other material facts, is legally erroneous in view of the decision of the Supreme Court in *Commissioner of Internal Revenue v. Culbertson*, supra.

Apparently the effort of the United States Supreme Court in *Commissioner v. Culbertson* to clarify its meaning in the *Tower* and *Lusthaus* cases was not entirely successful. In *Greenberger v. Commissioner*, supra, the Commissioner asserted that *Culbertson* represented only an affirmation of the rationale of *Tower* and *Lusthaus*. However, the Eighth Circuit Court doubted the validity of that contention (p. 992). That there has been confusion, uncertainty and misapplication of the meaning of the decision of the Supreme Court in *Commissioner v. Culbertson* by many court decisions is emphasized in the recent case of *Alexander v. Commissioner of Internal Revenue*, 5th Cir., No. 13482, March 6, 1952, P-H Tax Service Paragraph 72,337, Footnotes (2) and (3).

“In Sec. 7 of the Senate Finance Committee Report on H.R. 4473, Proposed Revenue Act of 1951, dealing with family partnerships, and in the Ways and Means Committee Report on the

same subject, the present confused state of the law is thus summarized:

“ ‘Section 339 of your committee’s bill is intended to harmonize the rules governing interests in the so-called family partnership with those generally applicable to other forms of property or business. Two principles governing attribution of income have long been accepted as basic: (1) income from property is attributable to the owner of the property; (2) income from personal services is attributable to the person rendering the services. There is no reason for applying different principles to partnership income. If an individual makes a bona fide gift of real estate, or of a share of corporate stock, the rent or dividend income is taxable to the donee. *Your committee’s amendment makes it clear that, however the owner of a partnership interest may have acquired such interest, the income is taxable to the owner, if he is the real owner. If the ownership is real, it does not matter what motivated the transfer to him or whether the business benefited from the entrance of the new partner.*

“ ‘Although there is no basis under existing statute for any different treatment of partnership interests, some decisions in this field have ignored the principle that income from property is to be taxed to the owner of the property. Many court decisions since the decision of the Supreme Court in *Commissioner v. Culbertson* (337 U.S. 733 [37 AFTR 1391]) have held invalid for tax purposes family partnerships which arose by virtue of a gift of a partnership interest from one

member of a family to another, where the donee performed no vital services for the partnership. Some of these cases apparently proceed upon the theory that a partnership cannot be valid for tax purposes unless the intrafamily gift of capital is motivated by a desire to benefit the partnership business. Others seem to assume that a gift of a partnership interest is not complete because the donor contemplates the continued participation in the business of the donated capital. However, the frequency with which the Tax Court, since the Culbertson decision, has held invalid family partnerships, based upon donations of capital, would seem to indicate that, although the opinions, often refer to 'intention', 'business purpose', 'reality', and 'control', they have in practical effect reached results which suggest that an intrafamily gift of a partnership interest, where the donee performs no substantial services, will not usually be the basis of a valid partnership for tax purposes. We are informed that the settlement of many cases in the field is being held up by the reliance of the field offices of the Bureau of Internal Revenue upon some such theory. Whether or not the opinion of the Supreme Court in *Commissioner v. Tower* (327 U.S. 280 [34 AFTR 799]) and the opinion of the Supreme Court in *Commissioner v. Culbertson* (337 U.S. 733 [37 AFTR 1391]), which attempted to explain the *Tower* decision, afford any justification for the confusion is not material—the confusion exists.' (Emphasis supplied.)"

"(3) Sec. 7 of the Senate Finance Committee Report on H. R. 4473, etc., continues:

“ ‘The amendment leaves the Commissioner and the courts free to inquire in any case whether the donee or purchaser actually owns the interest in the partnership which the transferor purports to have given or sold him. Cases will arise where the gift or sale is a mere sham. Other cases will arise where the transferor retains so many of the incidents of ownership that he will continue to be recognized as a substantial owner of the interest which he purports to have given away, as was held by the Supreme Court in an analogous trust situation involved in the case of *Helvering v. Clifford* (309 U.S. 331). The same standards apply in determining the bona fides of alleged family partnerships as in determining the bona fides of other transactions between family members. Transactions between persons in a close family group, whether or not involving partnership interests, afford much opportunity for deception and should be subject to close scrutiny. *All the facts and circumstances at the time of the purported gift and during the periods preceding and following it may be taken into consideration in determining the bona fides or lack of bona fides of a purported gift or sale.*

“ ‘Not every restriction upon the complete and unfettered control by the donee of the property donated will be indicative of sham in the transaction. Contractual restrictions may be of the character incident to the normal relationship among partners. Substantial powers may be retained by the transferor as a managing partner or in any other fiduciary capacity which, when considered in the light of all the circumstances,

will not indicate any lack of true ownership in the transferee. In weighing the effect of a retention of any power upon the bona fides of a purported gift or sale, a power exercisable for the benefit of others must be distinguished from a power vested in the transferor for his own benefit.

“ ‘Since legislation is now necessary to make clear the fundamental principle that, where there is a real transfer of ownership, a gift of a family partnership interest is to be respected for tax purposes without regard to the motives which actuated the transfer, it is considered appropriate at the same time to provide specific safeguards—whether or not such safeguards may be inherent in the general rule—against the use of the partnership device to accomplish the deflection of income from the real owner.’ (Emphasis supplied.) ”

Turning again to the facts in the case at bar. It is quite clear that the Tax Court recognizes that actually there were valid gifts of capital in the business of Cochran & Celli to Bernice Cochran and Winifred Cochran (R. 192); this, and also by virtue of their rights under the partnership agreements, the crediting of capital to their investment accounts in the same manner as such capital was credited to all the accounts of all the partners, the actual crediting of their shares of net profits to them as in the case of all partners, their right to make withdrawals from the partnership (R. 174), especially the withdrawals as found by the Tax Court during the years 1942,

1943 and 1944, all clearly establish definite ownership of substantial capital in the partnership business by Bernice Cochran and Winifred Cochran. The objection of the Tax Court to recognition of the capital owned by the two daughters as grounds for their acceptance as partners for business purposes is based upon the testimony of Joseph E. Cochran that the reason he and Mrs. Cochran made the gifts of community capital to their daughters and brought them into the partnership was to give them equal treatment with the sons. The Tax Court said (R. 192): "While his motive was commendable, the fact remains the evidence fails to show the existence of any business purpose for bringing either of the two daughters into the partnership or that there was a bona fide intent that the two daughters be joined as partners in the business in question." In other words, the Tax Court holds that even though the daughters actually acquired and owned capital in the business and withdrew for their own personal use profits from the business during 1942, 1943 and 1944, they were not business partners because the gifts of capital were not made to the daughters for business reasons. This presents a curious anomaly commented on by the Seventh Circuit Court in *Greenberger v. Commissioner*, supra (p. 993). A curious anomaly indeed would be presented if the petitioners were required to account for and pay a tax upon income which they had no right to receive but which right existed solely and exclusively in the two daughters. It must be conceded that the two daughters had every right to their part-

nership capital and to their partnership income and the daughters no doubt could have successfully maintained an action against petitioners to recover their part of the partnership income had petitioners attempted to take or receive such income as their own.

Very recently, February 19, 1952, recognizing the need for further clarification of the principles governing the recognition of family members as partners for income tax purposes in cases of partnerships organized before January 1, 1951, in view of the amendment to the revenue laws clarifying partnerships organized after January 1, 1951 (Revenue Act of 1951, Sec. 340 (b); Internal Revenue Code, Sec. 191), the Commissioner of Internal Revenue issued a mimeograph stating the present position of the Bureau of Internal Revenue for taxable years beginning prior to January 1, 1951, with respect to family partnerships in which capital is a material income-producing factor. (Mim. 6767; P-H 1952 Tax Service Paragraph 76,179.) It is submitted that the sense of this mimeograph now brings the position of the Commissioner of Internal Revenue (respondent) in line with the position of the petitioners herein. The mimeograph states that if a questioned partner is the real and not a sham owner of an interest in the capital of a partnership business, and if such capital is necessary to the conduct of the business, such questioned partner is ordinarily entitled to recognition and that this is so whether or not he or she performs any services for the partnership. The mimeograph also states

that the Bureau does not adhere to the position that there is an absence of a required business purpose if a gift or other antecedent family transaction does not benefit the business in some way. Under the heading, "Motive and Business Purpose", in paragraph 3 on page 7, the mimeograph states,

"* * * An individual is entitled freely to dispose of his or her property so far as the income tax law is concerned and may give or sell interests in a business to members of his family. The question with which the law concerns itself is whether the individual has really done so. There is no requirement that intra-family gifts be *motivated* by a business purpose, which frequently they would not have, before the donee may be recognized as the owner for income tax purposes of the property given to him, and the same is true of other antecedent family transactions." (Our emphasis.)

"The *Culbertson* opinion stated a test of intent, whether 'the parties in good faith *and acting with a business purpose* intended to join together in the present conduct of the enterprise.' The Bureau considers that the test of business purpose may be satisfied by the single fact (if it be a fact) that the questioned partner has invested in the business money or property, **useful to the business** of which he or she is the real owner under the principles stated in section 1 hereof, even though such money or property had already been used in the business before the questioned partner acquired any interest therein.

* * *"

It is clearly evident in the case at bar that capital is an extremely important factor in the business of Cochran & Celli. (R. 112 and Exhibits Nos. 15-21, R. 62-75.) The capital consists of substantial real property, equipment, inventories, receivables, cash, etc. It should be observed that all partners rendering services received reasonable compensation for such services and such salary income was taxable to them. (R. 110, 111; Ex. No. 11, R. 60.) Only the income attributable to capital was credited to the capital accounts of the daughters. (R. 111.) (This is no different from the periods in 1943 and 1944 when Sidney Cochran and Lloyd Celli were away from the business and received no salaries and were credited only with the income attributable to their capital. (R. 60, Ex. No. 11, R. 177.))

It is of some importance to note that the United States Court of Appeals, Fifth Circuit, in No. 13544, on March 6, 1952, again reversed the Tax Court in *Culbertson* following the remand of the case by the United States Supreme Court in *Commissioner of Internal Revenue v. Culbertson*, supra. (P-H Tax Service, Paragraph 72,336.) The Fifth Circuit Court held that the contribution of capital by the questioned partners contemporaneously with their admission into the partnership qualified them to be recognized as real partners without the necessity of showing rendition of services.

It is submitted that in essence the meaning of the *Tower*, *Lusthaus* and *Culbertson* cases in respect to

the case at bar is that if the questioned partnership is not a sham, that is to say, is not an income tax avoidance device but, on the other hand, has been utilized for good faith reasons, the partnership must be recognized for income tax purposes if the income in question is attributable to capital used in the producing of income in the business really and truly owned by the questioned partners. (See *Greenberger v. Commissioner*, supra, at 992, 993.) In *Alexander v. Commissioner of Internal Revenue*, supra, at page 72,418, the court said:

“If there is anything which emerges with clarity from the decision in the Culbertson case, supra, and from the reports of the committees of Senate and House, quoted in notes 2 and 3 supra, it is that the artificial and so-called objective tests of the existence of a partnership, set up in the Tower and Lusthaus cases as conclusive, are not such. The question in each case is one of fact to be determined like any other fact question upon the evidence as a whole, and, as stated in the Committee Reports, ‘The same standards apply in determining the bona fides of alleged family partnerships as in determining the bona fides of other transactions between family members.’

“It, therefore is, and remains, true that the acid test for determining the question of the reality and validity vel non of a family partnership is to be found in the answer to the question: Was the arrangement real, honest and bona fide, so that all the ordinary incidents and effects of an agreement of partnership flow, each partner bound for the losses, each sharing in the profits,

in accordance with his agreement? If the answer is yes, whatever may be found to be the intent or results of the parties taxwise, there was a partnership. By the same token, if the answer is that the agreement was not real, with the intent and result that a partnership be created, but a sham, a fraud or a pretense, so that the reality behind the partnership form when unmasked shows itself to be the contrary of what was pretended, there is no partnership, whatever may have been the intent or result taxwise."

In the long family deliberations in 1936 and 1937, preceding the organization of Cochran & Celli, there was no thought of income tax avoidance. (R. 105, 118.) The partnership was planned and organized in good faith for good, valid, sound family business reasons. Joseph E. Cochran and Mabel Cochran, the parents of Bernice and Winifred Cochran, derived no economic enjoyment or benefit to their own personal advantage from the gifts of capital in the business which they made to their daughters. Gifts of capital were made to the daughters in the same way as to the sons, and just as effectively. The record clearly shows the separate identity and ownership of the invested capital accounts of the two daughters. (R. 60.) See: *Lucas v. Earl*, 281 U.S. 111, 74 L.Ed. 731; *Helvering v. Clifford*, 309 U.S. 331, 84 L.Ed. 788; *Burnet v. Leininger*, 285 U.S. 136, 76 L.Ed. 665. The partnership agreement, the terms of which are applicable to all of the other partners, including persons unrelated to the petitioners or the daughters, also

clearly stated that the daughters are the owners of the capital in the business allocated to them. (Paragraph 3, R. 30.) Paragraph 13 (R. 36) also specifically gives the daughters as partners the right to withdraw from the partnership upon thirty days' notice and take out of the business the book value of their interest required to be paid to them, together with interest on the unpaid balances as follows: 10% on the effective date of retirement and 20% of the balance within a period of five years from the date of retirement, but no less than one-fifth of the balance to be paid each year during the period of five years. It cannot be doubted that the capital and profits which the daughters owned and which they allowed to remain in the business served a business purpose (the same business purpose as served by the capital of their brothers) and that the association of the daughters with the other partners in the partnership thereby served a valuable business purpose. The daughters being bona fide owners of capital in the business, it must follow, must it not, that since their capital served a useful business purpose, there was a bona fide intent on the part of the daughters, their parents and the other partners that they should all be associated and joined together as partners in the business? Not only were the daughters entitled to their capital and profits attributable to such capital, but they were also obligated to bear losses and were liable not only as partners but contingently as individuals for any losses. In other words, they were not

less liable for the losses and obligations of the business than any of the other partners.

It should also be remembered that the daughters were accepted as partners by non-related persons, viz., the members of the Celli family, and this is an important factor to be considered as evidencing a valid partnership. (See *David S. Sherman v. Commissioner*, CCH Dec. 18,708(M), Dec. 20, 1951; *Edward A. Theurkauf*, 13 T.C. 529, CCH Dec. 17,226; Note: *Burnet v. Leininger*, 285 U.S. 136, 76 L.Ed. 665.)

If the daughters were acceptable as partners in the judgment of the members of the Celli family, to their brothers, and to their parents, the Tax Court cannot legally substitute its judgment for their judgment. In *Stanchfield v. Commissioner of Internal Revenue*, 8 Cir., 191 F. (2d) 826, p. 828, the court said:

“* * * The Tax Court may consider the facts of capital contribution and services rendered to the claimed partnership upon the question of the intent of the parties, but it may not substitute its judgment for that of the parties. *Id.*,* 337 U.S. at page 745, 69 S.Ct. at page 1215, 93 L.Ed. 1659. *Greenberger v. Commissioner*, 7 Cir., 177 F.2d 990, 994; *Nelson v. Commissioner*, 8 Cir., 184 F.2d 649; *Funai v. Commissioner*, 4 Cir., 181 F.2d 890.”

It is, therefore, submitted that the findings and decision of the Tax Court below are clearly erroneous

**Commissioner of Internal Revenue v. Culbertson.*

and that the decision should be reversed with directions to enter a decision for the petitioners.

Dated, San Francisco, California,
April 2, 1952.

Respectfully submitted,

ELI FREED,

EMMETT GEBAUER,

Attorneys for Petitioners.

No. 13,147

**In the United States Court of Appeals
for the Ninth Circuit**

**ESTATE OF MABEL COCHRAN, DECEASED; SIDNEY ELMER
COCHRAN AND DONALD ROBERT COCHRAN, EXECUTORS,
AND JOSEPH E. COCHRAN, PETITIONERS**

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

**ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX
COURT OF THE UNITED STATES**

BRIEF FOR THE RESPONDENT

ELLIS N. SLACK,
Acting Assistant Attorney General.

**A. F. PRESCOTT,
FRED E. YOUNGMAN,**
Special Assistants to the Attorney General.

FILED

MAY - 7 1952

PAUL P. O'BRIEN
CLERK

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ESTATE OF MABEL COCHRAN, DECEASED; SIDNEY ELMER
COCHRAN AND DONALD ROBERT COCHRAN, EXECUTORS,
AND JOSEPH E. COCHRAN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

*ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX
COURT OF THE UNITED STATES*

BRIEF FOR THE RESPONDENT

OPINION BELOW

The unreported memorandum findings of fact and opinion of the Tax Court are printed in the record at pp. 186-193.

JURISDICTION

This appeal involves deficiencies in federal income tax asserted against Joseph E. Cochran (herein sometimes referred to as the taxpayer) for the calendar years 1943 and 1944 in the respective amounts of \$10,078.72 and \$8,619.36, and similar deficiencies asserted against the estate of his deceased wife, Mabel

Cochran, for the calendar years 1943 and 1944 in the respective amounts of \$9,468.67 and \$8,005.14.¹ (R. 187.) The Commissioner of Internal Revenue duly issued his statutory notices asserting these deficiencies under date of October 17, 1949. (R. 7-8, 10, 12, 14.) Separate petitions for review by the Tax Court of the Commissioner's determinations were duly filed with the Tax Court on December 27, 1949, pursuant to Section 272 of the Internal Revenue Code. (R. 7-10, 11-14.) The cases were consolidated for hearing and decision by the Tax Court. (R. 187.) The decisions of the Tax Court affirming the Commissioner's determinations were entered July 16, 1951. (R. 193, 194.) The case is brought to this Court by a joint petition for review of the Tax Court's decisions filed by the taxpayer and the executors of his deceased wife's estate (who, in conjunction with the taxpayer, are herein sometimes referred to as the taxpayers) on October 8, 1951. (R. 195-198.) The jurisdiction of this Court is invoked under Section 1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether the finding of the Tax Court that for the years 1942, 1943 and 1944 taxpayers' daughters were not for federal income tax purposes bona fide members of the partnership Cochran & Celli is clearly erroneous.

¹ Computation of the deficiencies for 1943 also involves the income of the taxpayer and his deceased wife for 1942 by reason of the tax forgiveness provisions of Section 6 of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126.

STATUTE INVOLVED

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) [As amended by Sec. 1, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * *

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C. 1946 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(26 U.S.C. 1946 ed., Sec. 182.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.* — The term “partnership” includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term “partner” includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U.S.C. 1946 ed., Sec. 3797.)

STATEMENT

This case was submitted to the Tax Court on a stipulation of facts (R. 18-23) found by the Tax Court as stipulated (R. 187), supplemented by documentary evidence (R. 24-76, 88-92) and the oral testimony of several witnesses (R. 94-184).

For a number of years prior to December 31, 1937, the taxpayer and Bernardo Celli, Sr., owned and operated as copartners a Chevrolet automobile dealership in Oakland, California, under the firm name of Cochran & Celli. On December 31, 1937, Mabel Cochran was the

wife of the taxpayer and Anna Celli was the wife of Bernardo Celli, Sr. The partnership interest of the taxpayer and Bernardo Celli, Sr., in the firm of Cochran & Celli constituted community property of the partners and their wives under the laws of California. (R. 18-19, 188.)

Also, on December 31, 1937, the taxpayer and Mabel Cochran had four children, Bernice M. Cochran (who is married and herein sometimes referred to as Bernice C. Johnson), Winifred Cochran (also since married and herein sometimes referred to as Winifred C. Irwin), and Sidney Elmer Cochran, all adults, and Donald Robert Cochran, who was then seventeen years of age. Bernardo Celli, Sr., and his wife, Anna Celli, had two children, Bernardo Celli, Jr., and Lloyd Celli, both of whom were adults. In 1937 the two adult sons of the Cellis were employed in the partnership business, as was Sidney, the adult Cochran son. (R. 19, 189.)

On December 31, 1937, the opening credit balances of the taxpayer and Bernardo Celli, Sr., on the books of the Cochran & Celli partnership were \$242,914.94 and \$237,605.44, respectively. As of that date journal entries were made transferring \$100,617.43 from the investment account of the taxpayer to a new account set up in the name of Mabel Cochran and transferring \$102,024.88 from the Bernardo Celli, Sr., investment account to a new account set up in the name of Anna Celli. As of the same date other entries were made transferring amounts from each of the four parents to each of their respective adult children. Attached as Exhibits 1 through 6 to the stipulation of facts (R. 19-20, 24-29) are excerpts from the investment accounts

in the names of the taxpayer, his wife, and their four children on the books of the partnership showing entries relating to transfers from one investment account to another during the period from December 31, 1937, to December 31, 1944, inclusive. In addition to the above transfer of \$100,617.43 from the investment account of the taxpayer to the investment account in the name of his wife on December 31, 1937, these exhibits show that on the same date, December 31, 1937, there were transferred from the investment account of the taxpayer and also from that of his wife the sum of \$16,818.21 as a credit to the investment account set up in the name of each of their three adult children; that as of March 31, 1941, there were transferred from the investment accounts of the taxpayer, his wife, and each of their three adult children, as a gift to Donald R. Cochran (who had just attained his majority), the sum of \$4,000, which amounts were set up in the investment account opened in the name of Donald R. Cochran as his initial cash contribution to the partnership capital; that as of March 31, 1942, there were transferred from the investment accounts of the taxpayer, his wife, and each of their three older children, as a further gift to Donald R. Cochran, the sum of \$4,000, which amounts were credited to the investment account of Donald R. Cochran as a further cash contribution to the capital of the partnership; that as of December 31, 1942, there were transferred from the investment account of the taxpayer and also from that of his wife, as a gift to each of their four children, the sum of \$4,000, which amounts were credited to the investment account of the respective donees; that as of January 31,

1943, there were transferred from the investment account of the taxpayer and also from that of his wife, as a gift to each of their four children, the sum of \$3,000, which amounts were credited to the investment account of the respective donees; that as of the same date, January 31, 1943, there were transferred from the investment account of each of the taxpayer's three older children, as a gift to Donald R. Cochran, the sum of \$2,500, which amounts were credited to the investment account of Donald R. Cochran as cash paid in to the capital of the partnership; and that as of April 30, 1944, there were transferred from the investment account of the taxpayer and from that of his wife, as a gift to each of their four children, the sum of \$3,000, which amounts were credited to the investment account of the respective donees as cash paid in. (R. 24-29.)

The above transfers on the books of the Cochran & Celli partnership were made as a part of a preconceived plan (R. 190), a part of which was the execution of a new partnership agreement under date of January 1, 1938, by the taxpayer and his wife, Bernardo Celli, Sr., and his wife, and all of the adult children of both families, for the continued conduct of the partnership business of Cochran & Celli under the same name.² This partnership agreement (a copy of which is attached as Exhibit 7 to the stipulation of facts (R. 20-21,

² The Tax Court found from the evidence (R. 190) that the withdrawals from the taxpayer's investment account, the credits to his wife's new investment account, the crediting of new investment accounts of the Cochran daughters, Bernice and Winifred, and their signing of the partnership agreement all took place within the months of November and December, 1937, and were all component parts of a single plan to make all members of the Cochran family copartners in the business.

29-43)) is very comprehensive in its terms. It recited the ownership by the contracting parties of the business theretofore conducted under the firm name and style of Cochran & Celli, and that the new partnership would continue to conduct the business under the same firm name, assuming all valid obligations, liabilities, or contracts of the business theretofore owned and conducted by the taxpayer and Bernardo Celli, Sr. The percentage of their respective contributions and their interest in the business were stated to be as follows (R. 30):

Name	Interest
J. E. Cochran	19.11%
Mabel Cochran,	10.44%
Bernice M. Cochran	7.00%
Winifred Cochran	7.00%
Sidney Elmer Cochran	7.00%
Bernardo Celli, Sr.	18.22%
Anna Celli	11.23%
Bernardo Celli, Jr.	10.00%
Lloyd Celli	10.00%

Among the more important provisions of the agreement of January 1, 1938, paragraph 4 (R. 31) provided for the inclusion of Donald Robert Cochran in the partnership upon his attaining legal age. Paragraph 5 (R. 31-32) gave to the taxpayer and Bernardo Celli, Sr., as "Managers", absolute and unqualified control of all phases of the partnership business, and paragraph 9 (R. 35) provided for perpetuation of this joint control by the two families in the event of the death of either manager by designating as his successor "Manager" the oldest surviving male partner of the deceased's family. The agreement was to continue for

one year, and on a year to year basis thereafter unless some partner gave written notice in advance of his desire to dissolve the partnership. See paragraph 12 (R. 36). Other provisions, not particularly material here, related to continuation of the business in the event of the death of a partner, the right of a partner to withdraw from the partnership and the right of the remaining partners to acquire his interest, dissolution, etc. Paragraph 24 (R. 42) provided that title to the real property owned by the partnership should be held in trust by Bernardo Celli, Jr., and Sidney Elmer Cochran for the benefit of the partnership, and a declaration of trust to that effect was executed by them as of January 1, 1938 (R. 21, 52-59).

On or about February 28, 1945, the parties to the agreement of January 1, 1938, and Donald Robert Cochran executed a document entitled "Amendment to Articles of Co-Partnership" (R. 21, 43-52) which, among other things, confirmed the participation of Donald Robert Cochran as a partner beginning in 1941 and set out a revised statement of the purported partnership interest of each signatory for the years 1938 to 1943, inclusive.

On March 15, 1938, the taxpayer and his wife each filed a federal gift tax return for the calendar year 1937 in which each reported gifts under date of December 24, 1937, in the respective amounts of \$16,818.21 to each of their three adult children, describing such gifts as "(3½%) J.E.C. interest in Partnership Cochran & Celli." On these returns each claimed an exclusion of \$15,000 and a specific exemption of \$35,454.63, and reported no tax due and paid no tax thereon. All subse-

quent purported gifts of partnership interest mentioned above were arranged in such amounts and made at such times as to preclude any gift tax liability. (R. 20, 189-190.)

In its findings of fact, which were based upon the oral testimony as well as the stipulation and exhibits, the Tax Court found, among other things, that (R. 189-191):

In order to perpetuate the Chevrolet franchise in their families and to interest their sons in staying in the business, the two partners decided in 1937 to take their sons into the business as copartners.

Under the new partnership agreement, dated January 1, 1938, not only the sons, but also Mabel Cochran, the wife of Joseph E. Cochran, Anna Celli, the wife of Bernardo Celli, Sr., and the Cochran daughters, Bernice and Winifred, were to be copartners in the business. The two Cochran daughters were included because their father felt morally obligated to give them as much as he gave his sons. There was also an understanding among the families that Donald Cochran was to become a partner when he reached his majority.

Under the new partnership agreement no additional capital was at any time invested in the business by any of the copartners. The source of the capital investments of the new copartners, who were members of the Cochran family, were withdrawals from the Joseph E. Cochran investment account. Such transfers were at all times treated by Joseph E. Cochran as gifts of interest in the business and in making them he took advantage of the community property laws of the State of Cali-

fornia by first crediting his wife's new investment account with a substantial part of the withdrawal from his account, and then spreading out over a period of years the transfers to the Cochran children of portions of his own and his wife's investments in the business, so that he and his wife filed gift tax returns for the year 1937 only and reported no gift tax due. When Donald Cochran was brought into the business as a copartner in 1941, his capital investment account was similarly set up as a result of transfers of capital from the accounts of his parents, brother and sisters in accordance with a verbal understanding existing at the time Sidney, Bernice and Winifred acquired their interests in the business.

* * * * *

The new partnership was managed by the two original partners, assisted by their sons. The Cochran daughters neither shared in the management or control of the new partnership, nor did they render any services to the business. In 1942, 1943 and 1944 both daughters made regular withdrawals of money from the accumulated profits of the partnership credited to their accounts.

There was no bona fide intent on the part of the copartners of Cochran & Celli and the two Cochran daughters, Bernice and Winifred, either when the partnership was formed or at any other time during the taxable years 1942, 1943 and 1944, that the two Cochran daughters were to be joined with members of the existing partnership of Cochran & Celli for the purpose of carrying on business as a partnership. Bernice Cochran Johnson and Winifred Cochran Irwin were not valid partners for income tax purposes in the business of Cochran & Celli during the years 1942, 1943 and 1944.

The taxpayer, his deceased wife, Mabel Cochran, and their daughters, Bernice Cochran Johnson and Winifred Cochran Irwin, each filed individual federal income tax returns for the calendar years 1943 and 1944 on which they reported gross income, income from the partnership of Cochran & Celli, net income, and income tax due, in the following amounts (R. 22-23, 188) :

1943				
	Gross Income	Income from Partnership	Net Income	Tax Due
J. E. Cochran.....	\$20,777.36	\$20,777.36	\$19,756.31	\$8,822.06
Mabel Cochran.....	15,977.36	15,977.36	15,325.13	6,701.60
Bernice C. Johnson.....	16,912.12	14,202.09	16,638.60	5,584.98
Winifred C. Irwin.....	15,910.30	14,202.09	15,605.32	5,481.02
1944				
J. E. Cochran.....	\$20,370.77	\$20,370.77	\$19,832.73	\$7,467.23
Mabel Cochran.....	15,570.77	15,570.77	15,039.85	4,949.93
Bernice C. Johnson.....	16,259.16	13,840.71	15,759.16	4,839.58
Winifred C. Irwin.....	15,551.95	13,840.70	15,051.95	4,955.98

The "Tax Due" in the above schedule for the year 1943 includes the unforgiven part of the 1942 tax. The "Income from Partnership" for the year 1944 includes a small amount of capital gain (\$318.30 or less) in each case. (R. 23, 188.)

In determining the deficiencies here involved the Commissioner added to the income reported by the taxpayer and his deceased wife, each, 50% of the income from the Cochran & Celli partnership reported by Bernice Cochran Johnson and Winifred Cochran Irwin.³ The correctness of the Tax Court's decision affirming this determination is the only issue for review here.

³ Copies of the deficiency notices were attached as exhibits to the petitions filed with the Tax Court, but are not included in the printed record.

SUMMARY OF ARGUMENT

Whether a bona fide partnership exists for federal income tax purposes is a question of fact to be determined from all the evidence. The Tax Court's findings are supported by substantial evidence and are not clearly erroneous. Neither daughter rendered any services for the partnership. Neither daughter contributed any capital which originated with her. The control of the partnership was retained by Mr. Cochran and Mr. Celli; upon their death passing to their sons, respectively. In the type of business the total partnership salaries paid were disproportionately low for the amount of its income.

ARGUMENT

There Is Substantial Evidence to Support the Tax Court's Finding That the Two Daughters Were Not Bona Fide Members of the Partnership for Federal Income Tax Purposes

This is another so-called family partnership case, of which this Court and the other appellate courts have had so many in recent years. In a great measure, these cases have been found to be mere reallocations of income among members of the immediate family group which, in many forms, the Supreme Court consistently has held cannot be availed of for purposes of reducing or avoiding federal income tax liability. See *Lucas v. Earl*, 281 U.S. 111; *Burnet v. Leininger*, 285 U.S. 136; *Helvering v. Clifford*, 309 U.S. 331; *Helvering v. Horst*, 311 U.S. 112; *Helvering v. Eubank*, 311 U.S. 122; *Harrison v. Schaffner*, 312 U.S. 579; *Helvering v. Stuart*, 317 U.S. 154, rehearing denied, 317 U.S. 602; *Commissioner v. Tower*, 327 U.S. 280; *Lusthaus v. Commis-*

sioner, 327 U.S. 293; *McWilliams v. Commissioner*, 331 U.S. 694; *Commissioner v. Sunnen*, 333 U.S. 591; *Commissioner v. Culbertson*, 337 U.S. 733. The principles particularly applicable in determining taxability of income of so-called family partnerships are settled by the decisions of the Supreme Court in *Burnet v. Leininger*, *supra*; *Commissioner v. Tower*, *supra*; *Lusthaus v. Commissioner*, *supra*; and *Commissioner v. Culbertson*, *supra*, as well as by many decisions by this Court and the other Courts of Appeals. See, among others, *Harkness v. Commissioner*, 193 F. 2d 655 (C.A. 9th), petition for writ of certiorari filed March 14, 1952; *Giffen v. Commissioner*, 190 F. 2d 188 (C.A. 9th), certiorari denied, 342 U.S. 918; *Parker v. Westover*, 186 F. 2d 49 (C.A. 9th); *Nordling v. Commissioner*, 166 F. 2d 703 (C.A. 9th), certiorari denied, 335 U.S. 817; *Battleson v. Commissioner*, 62 F. 2d 125 (C.A. 9th); *Quon v. Commissioner*, decided March 28, 1947 (1947 P-H T.C. Memorandum Decisions, par. 47,077), affirmed *per curiam*, 165 F. 2d 215 (C.A. 9th), certiorari denied, 334 U.S. 845.

The provisions of law involved are Sections 181 and 182 of the Internal Revenue Code, *supra*, which, so far as material here, provide that "Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity," and that in computing the net income of each partner he shall include in his income, whether or not distribution is made to him, his distributive share of the ordinary net income or the ordinary net loss of the partnership.

In this case, this taxpayer and his then partner, Bernardo Celli, Sr., in order to perpetuate their Chevrolet

franchise in their families and to interest their sons in staying in the business they had built up over the years, decided in 1937 to bring their sons into the business as partners. To this end the transactions outlined above were executed, including the execution of the purported partnership agreement dated January 1, 1938, by the original partners, their wives, and all of their adult children. The minor son of the taxpayer later was taken in as a partner when he became of legal age. The two Cochran sons and the two Celli sons, so far as the record shows, were actual members of the partnership during all of the periods here involved and the Commissioner has never questioned their status as such. Neither did he question the status of Mrs. Cochran or Mrs. Celli because of their community property interest under California law in the property and income of the business. However, in this proceeding he has taken the position that the taxpayer's married daughters, Bernice Cochran Johnson and Winifred Cochran Irwin, are not bona fide partners in the partnership of Cochran & Celli, and that under the facts and the law the income of the partnership reported as distributable to them for the years here involved is taxable to the taxpayer and the estate of his deceased wife as their community income. We submit there is no error in the Tax Court's decision sustaining the Commissioner's determination.

Although in this case a partnership existed which included the Cochran and Celli sons, the question whether Bernice C. Johnson and Winifred C. Irwin were bona fide members of that partnership would seem to be governed by the principles laid down by the Supreme

Court in the *Tower*, *Lusthaus*, and *Culbertson* cases, *supra*, and the decisions of this Court, cited above. In *Commissioner v. Tower*, *supra*, the Supreme Court said (p. 286) a partnership is created—

when persons join together their money, goods, labor, or skill *for the purpose of carrying on a trade, profession, or business* and when there is community of interest in the profits and losses. (Italics supplied.)

The Court then went on to say that when the existence of an alleged partnership is challenged by outsiders the question arises (p. 287)—

whether the partners really and truly intended to join together *for the purpose of carrying on business* and sharing in the profits or losses or both. *And their intention in this respect is a question of fact*, to be determined from testimony disclosed by their “agreement, considered as a whole, and by their conduct in execution of its provisions.” (Italics supplied.)

It was further pointed out in that case (p. 291) that such transactions calculated to reduce family taxes should always be subject to special scrutiny, and (p. 289) that the issue is who earned the income, which issue depends upon whether the parties “really intended to carry on business as a partnership.”

In *Commissioner v. Culbertson*, *supra*, the Supreme Court said (p. 740) that a partnership is “an organization for the production of income” to which each partner contributes one or both of the ingredients of income—capital or services. After quoting its statement in the *Tower* case, *supra*, to the effect that the question in that

case was whether the parties really and truly intended “to join together *for the purpose of carrying on business* and sharing in the profits or losses or both” (pp. 741-742, italics supplied), the Court emphasized (p. 742) that the question is not whether the services or capital contributed by a partner are of sufficient importance to meet some objective standard supposedly established by the *Tower* case, but whether, considering all the facts—the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their true intent—“the parties in good faith *and acting with a business purpose* intended to join together in the present conduct of the enterprise.” (Italics supplied.) The Court further pointed out that the intent of the parties is a question of fact to be determined by the trier of the facts.

That to be a valid partnership for federal income tax purposes ⁴ the association together of individuals must be for a present and genuine business purpose is emphatically demonstrated in this Court’s recent opinion in *Harkness v. Commissioner*, 193 F. 2d 655, petition for a writ of certiorari filed March 14, 1952. This Court’s opinion in the *Harkness* case also emphasizes

⁴ A “partnership” for purposes of the Internal Revenue Code is defined in Section 3797 (a) (2) thereof, *supra*, to include a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which “any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation.”

the factual nature of these so-called family partnership cases. See, also, *Battleson v. Commissioner*, 62 F. 2d 125 (C.A. 9th); *Nordling v. Commissioner*, 166 F. 2d 703 (C.A. 9th), certiorari denied, 335 U.S. 817; *Parker v. Westover*, 186 F. 2d 49 (C.A. 9th); *Giffen v. Commissioner*, 190 F. 2d 188 (C.A. 9th), certiorari denied, 342 U.S. 918. In the latter case this Court pointed out (p. 190) that "There was here no business purpose involved" in the alleged partnership.

The question here involved being a question of fact, the burden was upon the taxpayers to prove that Bernice C. Johnson and Winifred C. Irwin were bona fide members of the Cochran & Celli partnership. Cf. *Harkness v. Commissioner*, *supra*; *Giffen v. Commissioner*, *supra*; *Parker v. Westover*, *supra*. In this case the Tax Court found (R. 189): "The two Cochran daughters were included [in the partnership] because their father felt morally obligated to give them as much as he gave his sons." It further found (R. 191) that there was no bona fide intent on the part of the partners of Cochran & Celli and the two Cochran daughters, either when the partnership was formed or at any time during the taxable years here involved, that the latter "were to be joined with members of the existing partnership of Cochran & Celli for the purpose of carrying on business as a partnership"; that "Bernice Cochran Johnson and Winifred Cochran Irwin were not valid partners for income tax purposes in the business of Cochran & Celli during the years 1942, 1943 and 1944." In its opinion the Tax Court added (R. 192):

Petitioner Joseph E. Cochran testified that the reason he made his daughters partners in the busi-

ness was to afford them treatment equal to that he had shown his sons. While his motive was commendable, the fact remains the evidence fails to show the existence of any business purpose for bringing either of the two daughters into the partnership or that there was a bona fide intent that the two daughters be joined as partners in the business in question.

The question of intent of the parties being a question of fact to be determined from all of the evidence (*Commissioner v. Culbertson*, *supra*, pp. 743-745), it was for the Tax Court to weigh and draw its conclusions from all the evidence, conflicting or otherwise. (*United States v. Yellow Cab Co.*, 338 U.S. 338, 342; *United States v. Real Estate Boards*, 339 U.S. 485, 495-496). So long as its findings are supported by substantial evidence and are not shown to be clearly erroneous, due regard being given to the trier of the facts to judge the credibility of the witnesses they may not properly be set aside on appeal. Rule 52 (a) of the Federal Rules of Civil Procedure. *United States v. Gypsum Co.*, 333 U.S. 364, 395-396, rehearing denied, 333 U.S. 869; *Joe Balestrieri & Co. v. Commissioner*, 177 F. 2d 867, 873 (C.A. 9th); *Ruud v. American Packing & Provision Co.*, 177 F. 2d 538, 540 (C.A. 9th); *Grace Bros. v. Commissioner*, 173 F. 2d 170, 173 (C.A. 9th); *Harkness v. Commissioner*, 193 F. 2d 655, 658 (C.A. 9th), petition for a writ of certiorari filed March 14, 1952. "Whether the evidence would have supported a different finding by the Tax Court is a question not here presented." *Commissioner v. Tower*, 327 U.S. 280, 292.

We submit the taxpayers have failed to show that the Tax Court's findings in this case are clearly erroneous.

Taxpayers allege numerous errors on the part of the Tax Court (R. 201-207), both with respect to its ultimate finding that the two Cochran daughters were not bona fide partners in the Cochran & Celli partnership and with respect to its failure to find numerous evidentiary facts, which incidentally would not require a different ultimate finding by the Tax Court. In this respect the case is not unlike *Harkness v. Commissioner, supra*.

On brief it is admitted that whether a partnership exists for federal income tax purposes "is a question of fact to be determined, as any other fact, from all the evidence, * * *." (Br. 11.) On the other hand, and apparently overlooking the burden of proof placed upon the taxpayer in such cases, it is categorically stated that (Br. 10)—

There just is no factual support for the Tax Court's ultimate findings that there was no bona fide intent on the part of the copartners of Cochran & Celli to accept Bernice and Winifred Cochran as members of the partnership of Cochran & Celli for the purpose of carrying on business as a partnership, and that Bernice and Winifred were not true partners during the years 1942, 1943 and 1944.

Most of the taxpayers' argument is devoted to a discussion of the legal principles enunciated by the Supreme Court in the *Tower*, *Lusthaus*, and *Culbertson* cases, *supra*, to which we see no reason for taking exception and to their contention that the Tax Court mis-

applied those principles to the facts of this case, which we deny. In this respect the argument is not unlike that advanced by the taxpayers in *Harkness v. Commissioner, supra*, and we submit, on the record here, it is equally without merit. The basis of the argument as expressed in the taxpayers' own words is that (Br. 11-12)—

the Tax Court erroneously made its determination that no valid family partnership existed with respect to the two Cochran daughters by a strict application of the "vital services-original capital" test laid down in the *husband and wife* partnership cases of * * *. [*Commissioner v. Tower and Lusthaus v. Commissioner.*]

and that the Tax Court decided Bernice Cochran and Winifred Cochran were not valid partners for income tax purposes in Cochran & Celli for the years involved (Br. 15)—

because they did not perform any services for the partnership or participate in the management and control of the business, and because their investments of capital in the business did not originate with them but came from their parents.

The substance of the taxpayers' argument is that the Tax Court based its ultimate finding on these facts "without proper consideration of the other material facts" as required by *Commissioner v. Culbertson, supra*. (Br. 16.)

The argument is without merit. In its opinion the Tax Court said R. 192):

From a consideration of the entire record, we believe and hold that petitioners have failed to

meet the burden of proving the reality of the partnership insofar as the Cochran daughters are concerned.

In view of the Tax Court's statement this Court would hesitate to conclude otherwise. Cf. *In re 'Nathan's Estate*, 166 F. 2d 422, 426-427 (C.A. 9th), citing *Bank of California v. Commissioner*, 133 F. 2d 428, 431, 432 (C.A. 9th). Furthermore, the weight to be given the evidence is a matter resting exclusively with the Tax Court.

It is clear from the evidence in this case, and we do not understand counsel to contend otherwise, that the Cochran daughters contributed no services to the partnership other than incidental clerical services during school vacations, apparently all before the taxable years here involved and mostly if not all before January 1, 1938, for which they were compensated as any other employee; that they took no part whatever in the management of the business at any time; and that they contributed nothing to the capital of the business other than the purported gifts from their parents, plus any undrawn profits credited to their capital accounts. As the Tax Court found (R. 189): "The two Cochran daughters were included because their father felt morally obligated to give them as much as he gave his sons." There is nothing in the record to suggest that, either at the time the agreement was made or subsequently, they were expected ever to participate in the management or control of the partnership business, or to contribute to it anything in the way of services or capital, other than the so-called gift capital plus any

undrawn earnings of the business. All of the evidence, particularly the testimony of the taxpayer (R. 94-126) and of the two daughters, Bernice (R. 146-159) and Winifred (R. 160-168) is to the contrary. Both daughters were college graduates, were married, and were engaged in the profession of teaching in California high schools. Each apparently was self-supporting during the years, but there is nothing in the record to show that either was in a position to contribute to the financial needs, if any, of the partnership business. The Tax Court found (R. 189) that under the new partnership agreement no additional capital was at any time invested in the business by any of the partners. Furthermore, there is nothing in the record to show that any additional capital contributions were contemplated, other than accumulations of undrawn partnership profits.

In the *Culbertson* case, *supra*, the Supreme Court made it clear that a contribution of either capital or services is elemental. It said (p. 740):

A partnership is, in other words, an organization for the production of income to which each partner contributes one or both of the ingredients of income—capital or services.

Taxpayers complain because the Tax Court did not find the two Cochran daughters to be bona fide partners solely because of their contribution of so-called gift capital. (Br. 20-21.) In the *Culbertson* case, *supra* (pp. 745-748), the Supreme Court pointed out that the contribution of gift capital would not necessarily preclude the recognition of a valid family partnership

undertaking. But it was much more emphatic in saying in substance that a contribution of gift capital was not of itself sufficient to establish the existence of a valid family partnership relationship. It is only an element, although it may be an important one, in determining whether a valid partnership existed for income tax purposes. On the evidence as a whole, we are sure the Tax Court gave this factor full weight in making its disputed findings in this case. As this Court said in *Harkness v. Commissioner, supra* (p. 657), the primary test is one of intent, quoting with approval the following excerpt from the Tax Court's opinion in that case:

While such lack of a capital contribution originating with themselves is not in itself determinative of the partnership status of the Harkness children, yet the presence or absence of such a capital contribution is a significant test of whether the parties intended to form a bona fide partnership.

In the present case capital clearly was an important factor in the production of partnership income. While here the evidence fails to disclose any understanding among the parties that the children would leave their share of the partnership capital in the business, there certainly is no basis in the record for concluding otherwise. There is ample warrant in the record for the Tax Court's finding (R. 190) that the bookkeeping entries evidencing the changes in partnership interests and the execution of the agreement of January 1, 1938, "were all component parts of a single plan to make all members of the Cochran family copartners in the business."

It may be, as taxpayers claim (Br. 26-27), that under the partnership agreement the Cochran daughters

could have withdrawn from the partnership and taken out of the business the book value of their capital interest, in accordance with the provisions of the agreement of January 1, 1938, but this likewise is only one of the elements to be taken into consideration by the Tax Court in determining the intent of the parties. And there is no evidence that any such action was anticipated by the other signatories to the agreement or was contemplated by either of the Cochran daughters. Their testimony was that they considered it a good investment. The same consideration applies to the withdrawals of partnership income by the Cochran daughters during 1942, 1943 and 1944, although under the partnership agreement the "managers" had the power to determine what withdrawals could be made.

Nor is there any significance to the taxpayers' contention (Br. 28) that the Cochran daughters were accepted as partners by the Celli members of the partnership. Under the agreement of January 1, 1938, the management of the partnership business was divided equally between the Cochran and Celli families and the relative family interests in the business remained unchanged. The purported division of the Cochran family investment could under the circumstances be of only small concern to the members of the Celli families. Consequently, their acceptance of Bernice and Winifred Cochran as signatories to the agreement of January 1, 1938, would not compel a reversal of the Tax Court's ultimate findings.

There is nothing in the taxpayers' statement of the facts (Br. 1-9), which is inconsistent with the Tax Court's ultimate findings, although the statement (Br.

2) that the parents believed bringing the "children" into the business as partners would give them the incentive of ownership and keep them in the business is not entirely consistent with the taxpayer's own testimony (R. 99) that he and his partner wanted to keep their "boys" in the business; and that part of the statement relating to the interest taken in the business by the Cochran girls (Br. 7-8) seems somewhat embellished when considered in connection with all the evidence in the record. Nor do the taxpayers point to any evidence in the record which would require reversal on the ground that the Tax Court's findings are clearly erroneous.

Much is made by the taxpayers (Br. 16-20, 25) of the recent decision of the Court of Appeals for the Fifth Circuit in *Alexander v. Commissioner*, decided March 6, 1952 (1952 P-H, par. 72,337). All that need be said of the *Alexander* case is that it affirmed a finding by the Tax Court that no valid partnership existed for tax purposes. The same result should follow here.

Taxpayer cites Min. 6767, 1952-7 Int. Rev. Bull. 6-16, published by the Bureau of Internal Revenue on February 19, 1952. The citation of the small part of this mimeograph which appears on page 23 of the taxpayers' brief does not standing alone present a fair picture of the mimeograph, which must be considered as a whole. We submit that the mimeograph does not *require* the conclusion that a bona fide partnership exists merely because a gift of capital is made to a member of one's family and is left in the business, and is useful to the business. What this portion of the mimeograph stands for is that merely because such capital origi-

nated from a gift does not itself *require* the conclusion that the partnership will not be recognized for income tax purposes.

The mimeograph, after referring to the five principles announced in the *Culbertson* opinion, specifically provides (p. 7):

It is emphasized that this mimeograph does not attempt either to provide a ready formula¹ for the solution of family partnership cases or to state comprehensively all of the principles that are applicable in such cases. The matters here dealt with are accordingly to be understood in their relationship to the total fact picture in the particular case and to the basic principles of the *Culbertson* opinion set out above, which will not be further elaborated.

It further provides (p. 7):

1. *Reality of Capital Contribution*.—That a family member has acquired his partnership interest by, or as the result of, a gift, purchase, or loan from the taxpayer, and has not contributed to the partnership capital originating with himself, remains one of the factors to be considered. It should be understood, however, that the absence of “original” capital creates, rather than answers, the problem of whether an alleged partner is entitled to recognition. It presents in all cases an issue for the exercise of sound judgment on all of the facts of the particular case as to whether a partnership in good faith was intended by the parties.

The mimeograph does not lose sight of the control feature. At page 15 it deals with limited partners, and while stating there can be no hard and fast rule as to

the recognition of limited partners, it points out that limited partners generally have less control of the business. Here, the taxpayers do not contend that the two daughters were limited partners.

Nor does the mimeograph lose sight of the earner test. At page 15 it deals with the reasonableness of agreed division of profits, stating that a wholly unreasonable allocation thereof may be evidence of the absence of a bona fide partnership intent.

Where personal services are also an income-producing factor, and in an automobile agency business they are such, the amount of salaries paid to those who render services to the partnership is important. Here, the total salaries paid by the partnership range from about \$21,000 in 1942 to a little over \$17,000 in 1944. (R. 60.) The net income of the partnership in 1942, before deduction for salaries, amounted to over \$180,000, in the years 1943 and 1944 it amounted in each year to over \$200,000. (R. 76.)

In connection with the above we point to the concurring opinion of Judge Rives in *Alexander v. Commissioner* (C.A. 5th), decided March 6, 1952 (1952 C.C.H., par. 9232):

I concur in the result and in most of the opinion. When the opinion speaks of examining a claimed family partnership with an eye single to determining whether in law and in fact it is a reality or a sham, I take those words to mean not merely that the partnership must be valid according to state law standards, but also that it must be tested in the light of the economic realities underlying the federal income tax law. My understanding is that every contract, whether of trust, em-

ployment, partnership, or other business relationship, in order to be recognized in attributing income, must meet the tests of economic reality according to the concepts of the federal income tax law. * * *

* * * * *

In determining “whether the partnership is real within the meaning of the federal revenue laws”, (*Commissioner v. Tower*, 327 U.S. 290 [46-1 USTC par. 9189]) or whether “the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise”, (*Culbertson v. Commissioner*, 337 U.S. at 742 [49-1 USTC par. 9323]), we should apply the earner test (*Lucas v. Earl*, 281 U.S. 111 [2 USTC par. 496]) as well as the ownership test (*Helvering v. Clifford*, 309 U.S. 331 [48-2 USTC par. 9393]). Generally, partnership income is the product of both personal services and capital. The division of profits according to the partnership agreement must not be patently unreasonable when compared with the actual contributions of labor and capital of the family partners. See *Woosley v. Commissioner* (6th Cir. 1948), 168 Fed. (2d) 330, 333 [48-1 USTC par. 9292]; *Hartz v. Commissioner* (8th Cir. 1948), 170 Fed. (2d) 313, 318 [48-2 USTC par. 9393].

CONCLUSION

Here, the Tax Court, after considering all of the facts, hearing the testimony, and viewing the demeanor of the witnesses, found that the two daughters were not bona fide partners for income tax purposes. There is substantial evidence to support this finding. Its decisions should be affirmed.

Respectfully submitted,

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Acting Assistant Attorney General.

A. F. PRESCOTT,
FRED E. YOUNGMAN,
Special Assistants to the Attorney General.

APRIL, 1952.

No. 13,147

IN THE

United States Court of Appeals
For the Ninth Circuit

ESTATE OF MABEL COCHRAN, Deceased;
SIDNEY ELMER COCHRAN and DONALD
ROBERT COCHRAN, Executors, and
JOSEPH E. COCHRAN,

Petitioners,

VS.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' REPLY BRIEF.

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Attorneys for Petitioners.

FILED

MAY 29 1952

PAUL P. O'BRIEN

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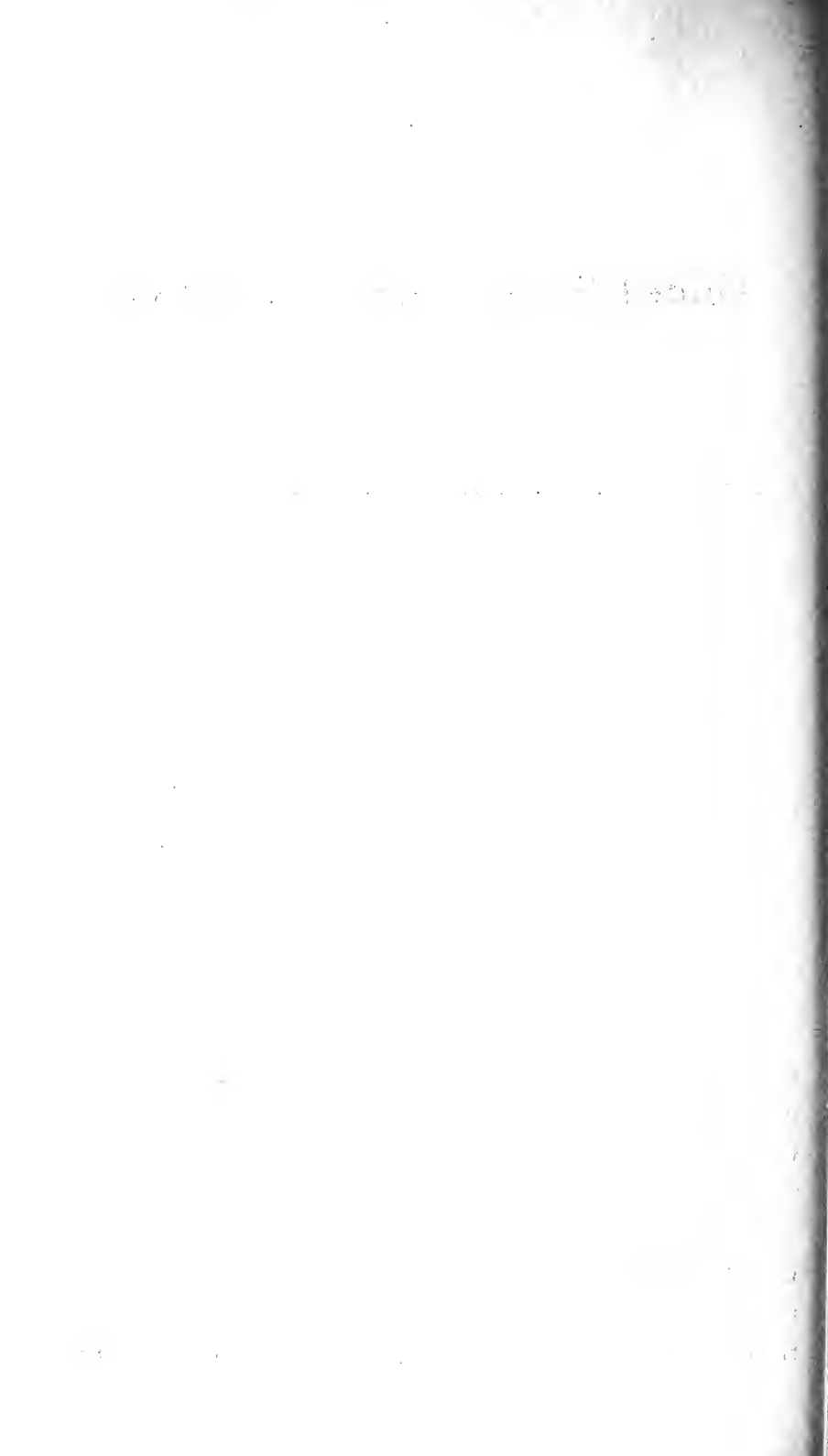
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No. 13,147

IN THE

**United States Court of Appeals
For the Ninth Circuit**

ESTATE OF MABEL COCHRAN, Deceased;
SIDNEY ELMER COCHRAN and DONALD
ROBERT COCHRAN, Executors, and
JOSEPH E. COCHRAN,

Petitioners,

VS.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' REPLY BRIEF.

ARGUMENT.

Respondent's brief makes it patently clear that there is no dispute with the petitioners regarding the material facts of the controversy as found by the Tax Court. Practically all of the material evidence was stipulated; there was no conflict in the testimony of the witnesses; there was no fact found by the Tax Court which varied from the testimony of the witnesses. Under these circumstances there is no question of credibility of witnesses involved. Nor does the

Tax Court's statement, to which respondent attaches importance (R.B. 21, 22), that its decision was arrived at from a consideration of the entire record, add anything of significance, for presumably all decisions of the Tax Court, whether correct or otherwise, are made after a consideration of the record, in its entirety and not in part.

However, it is the findings of fact of the Tax Court which lie at the base of the Tax Court's decision. In the case at bar, the Tax Court's ultimate finding of fact is nothing more nor less than its ultimate decision of law, and it is submitted that its ultimate finding of fact is not the kind of finding to be set aside for clear error as provided in Rule 52(a) of the Federal Rules of Civil Procedure. On the contrary, the ultimate finding of fact is actually a conclusion of law, the ultimate finding here being that Bernice Cochran Johnson and Winifred Cochran Irwin were not valid partners in the partnership business of Cochran & Celli during the years 1942, 1943 and 1944. (R. 191.) The predicate for this ultimate finding is the finding or conclusion that there was no bona fide intent on the part of the copartners of Cochran & Celli, either when the partnership was formed or at any other time during the taxable years 1942, 1943 and 1944, that the two Cochran daughters were to be joined with the other members of Cochran & Celli for the purpose of carrying on business as a partnership. It is submitted that this predicate is of the character of a mixed finding of fact and conclusion of law. It is a conclusion of law in this instance because it fol-

lows from findings of fact based upon the undisputed facts in this case; and such findings are accepted by petitioners. The rule of clear error prescribed in Rule 52(a) of the Federal Rules of Civil Procedure is therefore not applicable to this appeal because there is no claim that any of the findings of fact should be set aside.

The issue presented by respondent's brief therefore is actually whether the Tax Court was legally correct in deciding that from its findings of fact and the stipulated facts, it was obliged to conclude that there was no bona fide intent that the two Cochran daughters be joined as partners because from the facts found there did not appear to be any business purpose for bringing either of the two daughters into the partnership in the year 1937, and more particularly that in the years involved, viz., 1942, 1943, and 1944, there was no business purpose for including either of the two daughters in the partnership.

Or, putting it another way, respondent's brief presents the issue whether the Tax Court was legally correct in deciding that there was no such bona fide intent because the daughters did not contribute as capital to the partnership, property originating with them independently of their parents, but, on the other hand, contributed as capital property which they acquired by gift from their parents, capital already in the business. It is recognized, of course, that the question of bona fide intent in such a case is affected by the other facts found by the Tax Court. However, it is submitted that all of the other facts are not only

consistent with but affirmatively and effectively prove the claim of the petitioners that there was a bona fide partnership.

A significant fact throwing light on the question is that the Tax Court recognized (R. 192) that the gifts of capital to the daughters by the parents were bona fide completed gifts, particularly in respect to the years involved, viz., 1942, 1943 and 1944, which, for the purpose of this controversy, are controlling; and that further, in the years involved the Tax Court specifically found that both daughters made personal use of the profits from the business of Cochran & Celli attributed to their capital in the partnership. (R. 191, 192.)

It is submitted, therefore, that contrary to the assertion made by respondent that the petitioners overlooked their burden of proof, the findings of fact of the Tax Court and the undisputed evidence, including the stipulated facts, underlying such findings of fact sustain and compel an ultimate finding that the daughters were true partners during 1942, 1943 and 1944, and that there was a bona fide intent on the part of the copartners of Cochran & Celli to include the daughters as members of the partnership of Cochran & Celli for the purpose of carrying on business as a partnership. (R.B. 20.)

Petitioners have no reason to disagree with this court's decision in *Harkness v. Commissioner*, 193 F. (2d) 655, 658 (C.A. 9th) (petition for writ of certiorari denied), which is clearly distinguishable on its

facts from the case at bar. In *Harkness*, the primary contribution of the children was intended to be the services of the son and the daughter's husband, and such services were obviously not expected until the future when the son and son-in-law would be discharged from the armed forces. There was no gift of present capital by the parents to the children. On the other hand, the capital in the business ascribed to the children was to be acquired by them by payment from the profits of the business to be allocated to them. Furthermore, the alleged need for additional capital in the business was obviously to be supplied principally by accumulation of profits from tax savings on the income to be allocated to the children. Still further, it was found by the Tax Court that one of the reasons for the organization of the partnership was the taxes to be saved from the allocation of income to the son and daughter. On these facts, the Tax Court held, and such holding was affirmed by the Circuit Court, that although there was an intention to form a partnership it was not a present partnership but a partnership to come into existence in the future when the services contemplated would be available.

In the case at bar there was no finding and it was not the case that any tax savings were contemplated. In 1942, 1943 and 1944, the years involved herein, the ownership of capital by Bernice Cochran Johnson and Winifred Cochran Irwin was well entrenched; each year their capital was reinvested under the terms

of the partnership agreement. In 1942, 1943 and 1944 the partnership was five years, six years, and seven years old. The daughters had and exercised the enjoyment of the income attributable to their capital. Their capital in the business served an important business function in the production of the income (see R.B. 24), and the inclusion of the daughters in the partnership business in those years was therefore very material.

Though there are no findings of fact on the subject by the Tax Court, respondent, nevertheless, raises the suggestion that the amounts paid as salaries to the working partners, including the Celli members, may have been unreasonably low for their services and that this would be important in the consideration of the existence of a bona fide partnership intent. (R.B. 28.) It is submitted that the Tax Court of course made no such finding. Furthermore, the record reveals that the salaries that were paid were agreed upon among the partners, including the Celli members, after due consideration and the amounts were fixed according to what was considered right. (R. 110, 111.)

The court's attention is called to further consideration given to the "family partnership" by the Circuit Court of Appeals, Fifth Circuit, in *L. W. Seabrook v. Commissioner* (Decision No. 13,677, April 18, 1952, P-H Tax Service Par. 72,411). The Fifth Circuit has again decided in line with its recent reversal of the Tax Court in *Culbertson et al. v. Commissioner of*

Internal Revenue, 194 F. (2d) 581, that the Tax Court, despite the admonition in *Commissioner v. Culbertson*, 337 U.S. 733, "has continued in its adherence to the view that it is essential to membership in a family partnership for tax purposes that the capital contributed be 'original capital' or that the partners contribute 'vital services' or participate in the management and control of the business." It is the conclusion of the court in *Seabrook v. Commissioner*, supra, that the Tax Court determined erroneously that the absence of "original capital" in a family partnership was itself decisive of the lack of bona fide intent to form a partnership. A fair reading of the decision of the Tax Court in the case at bar justifies the same conclusion, and it is only on this premise that the Tax Court's decision in this case can be really understood.

Petitioners refer the court to their opening brief for reply to the other discussion in respondent's brief.

CONCLUSION.

It is submitted to this court that the Cochran & Celli partnership, including the daughters, not being a sham or subterfuge and not having been availed of for tax purposes, and not being a mere temporary re-allocation of income within a family, but having been formed some years ago for an honest purpose real to the parties, which gave equal recognition to the capital and earnings of the Cochran daughters,

the fruits of which were actually enjoyed by them, should be recognized as a valid partnership for tax purposes; that the Tax Court was clearly in error in attaching a controlling and erroneous significance to the fact that the capital invested in the partnership by the Cochran daughters in 1942, 1943 and 1944 was derived from capital that was obtained by them as gifts from their parents in 1937.

Dated, San Francisco, California,

May 26, 1952.

Respectfully submitted,

ELI FREED,

EMMETT GEBAUER,

Attorneys for Petitioners.

No. 13148

United States
Court of Appeals
for the Ninth Circuit.

HUGH H. EARLE, Collector of Internal Revenue
for the District of Oregon,

Appellant,

vs.

W. J. JONES & SON, INC., a Corporation,

Appellee.

Transcript of Record

Appeals from the United States District Court,
for the District of Oregon.

FILED

FEB 12 1952

PAUL P. O'BRIEN

CLERK



No. 13148

United States
Court of Appeals
for the Ninth Circuit.

HUGH H. EARLE, Collector of Internal Revenue
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In the United States District Court
for the District of Oregon

Civil No. 5758

W. J. JONES & SON, INC.,

Plaintiff,

vs.

HUGH H. EARLE, Collector of Internal Revenue
for the District of Oregon,

Defendant.

DOCKET ENTRIES

1950

Sept. 27—Filed complaint.

Sept. 27—Issued summons—to marshal.

Oct. 3—Filed summons with marshal's return.

Nov. 24—Filed answer.

1951

Feb. 12—Entered order setting for pretrial conference on March 26, 1951.

Mar. 26—Entered order setting for pretrial conference on April 2, 1951.

Apr. 2—Record of pretrial conf. & order setting for further pretrial conf. on April 9, at 2:00 p.m.

Apr. 9—Record of pretrial conf.

Apr. 10—Entered order setting for trial on May 15, 1951.

May 7—Filed & entered pretrial order.

May 15—Entered order permitting A. F. Oehmann to appear specially for deft; record of trial before court.

1951

- May 16—Record of trial before court; argument & order taking under advisement.
- June 12—Filed & entered Findings of Fact, Conclusions of Law and Judgment for plaintiff.
- June 12—Filed exhibits.
- June 30—Filed transcript of testimony of May 15-16, 1951.
- Aug. 8—Filed notice of appeal by defendant and copy mailed to attys. for plaintiff.
- Sept. 14—Filed motion of U. S. for extension of time to file appeal.
- Sept. 14—Filed & entered order extending time 90 days from first appeal date.
- Oct. 24—Filed designation of contents of record on appeal.
- Oct. 31—Filed affidavit of service of copy of designation.
- Oct. 31—Filed stipulation for order for clerk to transmit exhibits to U. S. Court of Appeals.
- Oct. 31—Filed and entered order for clerk to transmit exhibits to U. S. Court of Appeals.

[Entries in Civil Docket No. 5759 are identical to the foregoing.]

In the United States District Court for the
District of Oregon

Civil No. 5758-94-8

W. J. JONES & SON, INC.,

Plaintiff,

vs.

HUGH H. EARLE, Collector of Internal Revenue
for the District of Oregon,

Defendant.

COMPLAINT

Comes now the plaintiff and for cause of action
alleges:

I.

Plaintiff, W. J. Jones & Son, Inc., is a corporation duly organized and existing under the laws of the State of Oregon, maintaining its principal office in Portland, Oregon, and brings this action to recover a refund of income taxes illegally collected or retained by defendant Collector of Internal Revenue. Jurisdiction of this Court exists by virtue of 28 U.S.C. Sec. 1340.

II.

The defendant, Hugh H. Earle, was on and subsequent to September 1, 1947, and now is the duly appointed and acting Collector of Internal Revenue for the District of Oregon.

III.

On or about March 15, 1949, plaintiff filed its

income tax return for the calendar year 1948 in conformity with the Internal Revenue Code of the United States which return discloses a net operating loss of \$138,379.48.

IV.

Under Internal Revenue Code Sec. 122 plaintiff is entitled to carry back to 1946 said 1948 operating loss of \$138,378.48, and the net operating loss deduction resulting from such carry-back completely absorbs all of plaintiff's 1946 net income entitling plaintiff to a refund of the 1946 income taxes paid by plaintiff in the sum of \$12,190.32. Said 1946 income taxes in the sum of \$12,190.32, disclosed on the 1946 income tax return duly filed by plaintiff on or about March 15, 1947, were paid by plaintiff in installments of \$3,500.00 on March 14, 1947; \$3,500.00 on June 14, 1947, and \$5,190.32 on September 13, 1947. Refund is herein sought for the \$5,190.32 of said \$12,190.32 paid by plaintiff to defendant on September 13, 1947. Refund of the \$3,500.00 paid by plaintiff on March 14, 1947, and June 14, 1947, is sought in an action against the United States of America filed simultaneously with this complaint.

V.

The net operating loss deduction resulting from the \$138,378.48 net operating loss for 1948 is only partially absorbed by plaintiff's 1946 net income, and under the provisions of Internal Revenue Code Sec. 122 plaintiff is entitled to deduct from 1947 income the portion of said net operating loss de-

duction which remains after eliminating plaintiff's 1946 net income. Said 1947 net operating loss deduction entitles plaintiff to a refund of \$38,030.29 of the income taxes paid by plaintiff for the year 1947. Income taxes in the sum of \$154,791.75 disclosed on the 1947 income tax return duly filed by plaintiff on or about March 15, 1948, were paid by plaintiff in installments on March 15, 1948; June 15, 1948; September 15, 1948; October 1, 1948, and December 10, 1948.

VI.

On or about November 2, 1949, plaintiff duly filed with defendant a refund claim for income taxes in the sum of \$12,690.32 paid by plaintiff for the calendar year 1946, and a refund for \$38,030.29 of the income taxes paid by plaintiff for the calendar year 1947. Said refund claims for 1946 and 1947 set forth the reasons for the allowance of said claims together with the computations of the amounts thereof, and said refund claim for 1946, attached to the complaint filed by plaintiff against the United States of America, and said refund claim for 1947, hereto attached as Exhibit A, are incorporated herein by reference as though fully set forth in this complaint.

VII.

The net operating loss in the sum of \$138,379.48 disclosed by plaintiff's 1948 income tax return is the basis for substantially all the amount for which refund is herein sought. Of said \$138,379.48 net operating loss, \$134,555.21 constitutes a bad debt deduction under I.R.C. Sec. 23 (k).

VIII.

The 1948 bad debt deduction in the sum of \$134,555.21 is based upon the worthlessness of certain 6 per cent demand notes acquired by plaintiff in 1946 for the sum of \$121,763.74, the face amount of said notes plus accrued interest to the date of acquisition. The notes were issued by Mina del Refugio, a Mexican corporation at Hermosillo, Sonora, Mexico, to secure loans made to said corporation. Gold and silver mining operations carried on by said corporation were curtailed and finally terminated in the latter part of 1948 when the original veins of ore were unexpectedly exhausted and all attempts to discover additional ore were unsuccessful. At a meeting held on December 27, 1948, the board of directors of said corporation ratified the termination of all operations and confirmed the sale of all equipment pursuant to a contract previously entered into, and further directed the immediate abandonment of all real property, mining claims and all other assets of said corporation including the corporate structure. At said meeting the directors determined that not more than \$22,500.00 could be salvaged from the corporation, and directed that any amount so realized should be distributed pro rata to the holders of the outstanding notes of the corporation. The notes owned by taxpayer for the indebtedness of \$121,763.74 constituted 39 per cent of the total indebtedness of \$308,378.39 secured by notes of said corporation. The pro rata distribution of said \$22,500.00 entitled the plaintiff to payment of an amount not in excess of \$8,775.00 (39

per cent of \$22,500.00) upon said indebtedness of \$121,763.74, leaving the debts totally worthless in the amount of \$112,988.74, (\$121,763.74 less \$8,775.00). While plaintiff held said notes it accrued interest thereon in the amount of \$21,566.47 which added to said sum of \$112,988.74 constitutes the bad debt deduction of \$134,555.21.

IX.

Said notes constituted valid debts of Mina del Refugio and were not subordinated to creditors, nor did said notes provide for payment only out of the earnings of said corporation. Shares of the common stock of Mina del Refugio were owned by persons other than those making loans to said corporation and it was the intention of parties that the loans should be repaid to the lenders before any profits were distributed to the stockholders. Consequently stock could not have been issued in lieu of said notes.

X.

It was the intention of the parties concerned that said notes should constitute valid debts of Mina del Refugio and they were so treated by plaintiff and by said corporation. One indication of such intent is the fact that plaintiff accrued the interest upon said notes and plaintiff paid an income tax thereon.

XI.

The Commissioner of Internal Revenue has not mailed to plaintiff by registered mail any notice of

the disallowance of said refund claims although plaintiff has received letters from the Internal Revenue Agent in Charge, Seattle, Washington, dated March 10, 1950, which propose substantial disallowance of said refund claims on the ground that the notes represent contributions to capital of Mina del Refugio rather than debts of said corporation. More than six months have elapsed since the filing of said refund claims by plaintiff.

XII.

The income tax for which refund is herein claimed is being withheld from plaintiff because of the action of defendant in illegally and erroneously denying plaintiff the aforementioned net operating deductions to which plaintiff is entitled for the years 1946 and 1947.

Wherefore, plaintiff demands judgment against the defendant for the sum of \$43,220.61 plus interest and costs, said sum of \$43,220.61 being \$5,190.32 for 1946 income taxes and \$38,030.29 for 1947 income taxes.

WILBUR, BECKETT, OPPEN-
HEIMER, MAUTZ & SOUTHER.

By /s/ WILLIAM H. KINSEY,
Attorneys for Plaintiff.

EXHIBIT A

Form 843

Treasury Department

Internal Revenue Service

CLAIM

To Be Filed With the Collector Where Assessment
Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse.

- ☐ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

Collector's Stamp (Date received):.....

State of Oregon,
County of Multnomah—ss. .

Name of taxpayer or purchaser of stamps:

W. J. Jones & Son, Inc.

Business Address:

817 Board of Trade Bldg., Portland, Oregon.

Residence:

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed: Oregon.
2. Period (if for tax reported on annual basis, prepare separate form for each taxable year): From Jan. 1, 1947, to Dec. 31, 1947.
3. Character of assessment or tax: Income taxes.
4. Amount of assessment, \$154,791.75; dates of payment, 1948.
5. Date stamps were purchased from the Government:
6. Amount to be refunded: \$38,030.29.
7. Amount to be abated (not applicable to income, gift, or estate taxes): \$.
8. The time within which this claim may be legally filed expires, under Section 322 of I.R.C., on March 15, 1950.

The deponent verily believes that this claim should be allowed for the following reasons:

1. There is a net operating loss deduction in 1947 attributable to the carry-back of a net operating loss sustained in 1948 to 1946 and the carry-forward from 1946 of the amount of the net operating loss deduction not absorbed by 1946 net income to 1947 (see attached).

/s/

W. J. Jones & Son, Inc.
Portland, Oregon

Claim for Refund

Calendar Year 1947

Net operating loss shown on 1947 Corporation	
Income tax return	\$138,379.48
Less: Contributions deducted on return not allowable under limitations of Sec. 23(q)	
I. R. C.	446.00
Net operating loss shown on return, as adjusted.....	\$137,933.48
Less: Adjustments required by Sec. 122(d) I.R.C.	—
Statutory net operating loss for 1948.....	\$137,933.48
Carry-back of 1948 net operating loss to 1946.....	\$137,933.48
Less: 1946 net income adjusted	37,853.75
Net operating loss deduction available to carry-back to 1947	\$100,079.73
Reduction under Sec. 122(d) I. R. C.:	
Net income for 1947 disclosed by return	\$407,346.72
Adjustments under Sec. 122(d)	
I. R. C.	—
Net income adjusted	\$407,346.72
Less: Normal tax net income	407,346.72
Excess of net income adjusted over normal tax net income	—
Net operating loss deduction applicable to 1947.....	\$100,079.73
Normal tax net income shown by return	\$407,346.72
Less: Net operating loss deduction.....	100,079.73
Normal tax net income adjusted	\$307,266.99
Normal tax, as adjusted	\$ 73,744.08
Surtax, as adjusted	43,017.38
Tax liability as adjusted	\$116,761.46
Tax liability shown on return	154,791.75
Decrease	\$ 38,030.29

State of Oregon,
County of Multnomah—ss.

I, Clayton R. Jones, being first duly sworn, depose and say that I am President of W. J. Jones & Son, Inc., plaintiff in the above-entitled action; and that the foregoing complaint is true as I verily believe.

/s/ CLAYTON R. JONES.

Subscribed and sworn to before me this 27th day of September, A.D. 1950.

[Seal] /s/ WILLIAM H. KINSEY,
Notary Public for the
State of Oregon.

My Commission expires 12/21/52.

[Endorsed]: Filed Sept. 27, 1950.

[Title of District Court and Cause.]

Civil No. 5758

ANSWER

Defendant answers as follows:

I.

Admits the allegations contained in Paragraph I of the Complaint except denies that the taxes sought to be recovered, or any portion thereof, were illegally collected or retained.

II.

Admits the allegations contained in Paragraph II of the Complaint.

III.

Denies all the allegations contained in Paragraph III of the Complaint except admits that on or about March 15, 1949, plaintiff filed its Income Tax Return for the Calendar Year 1948 in which there was disclosed an alleged operating loss in the amount of \$138,379.48.

IV.

Denies all of the allegations contained in Paragraph IV of the Complaint except admits that the returned 1946 income taxes, in the alleged amount, were paid in installments on or about the dates alleged.

V.

Denies all of the allegations contained in Paragraph V of the Complaint except admits that the returned 1947 income taxes, in the alleged amount, were paid in the installments and on or about the dates alleged.

VI.

Denies all of the allegations contained in Paragraph VI of the Complaint except admits that plaintiff filed with the Collector of Internal Revenue for the District of Oregon on November 4, 1949, an instrument in writing purporting to be a claim for refund for the calendar year 1946, in the amount of \$12,190.32, and on the same date filed with the Collector of Internal Revenue for the District of

Oregon an instrument in writing purporting to be a claim for refund for the calendar year 1947, in the amount of \$38,030.29, and admits that Exhibit "A" to the Complaint is a true copy thereof.

VII.

Denies all of the allegations contained in Paragraph VII of the Complaint.

VIII.

Defendant specifically denies that plaintiff is entitled to a bad debt deduction in the amount alleged, or in any other amount. Further answering the allegations of Paragraph VIII of the Complaint, defendant avers that he is without knowledge or information sufficient to form a belief as to the truth of any of the remaining allegations contained in that paragraph.

IX.

Denies all of the allegations contained in Paragraph IX of the Complaint.

X.

Denies all of the allegations contained in Paragraph X of the Complaint.

XI.

Admits the allegations contained in Paragraph XI of the Complaint.

XII.

Denies all of the allegations contained in Paragraph XII of the Complaint.

Wherefore, having fully answered, defendant prays judgment and costs.

HENRY L. HESS,

United States Attorney for the
District of Oregon.

/s/ DONALD W. McEWEN,
Assistant United States
Attorney.

United States of America,
District of Oregon—ss.

I, Donald W. McEwen, Assistant United States Attorney for the District of Oregon, hereby certify that I have made service of the foregoing Answer on the plaintiff herein by depositing a duly certified copy thereof in the United States Post Office at Portland, Oregon, on November 24, 1950, said copy being enclosed in an envelope with postage thereon prepaid, addressed to Messrs. Wilbur, Beckett, Openheimer, Mautz & Souther; William H. Kinsey, Attorneys at Law, 1001 Board of Trade Building, Portland 4, Oregon, attorneys of record for plaintiff herein.

/s/ DONALD W. McEWEN,
Assistant United States
Attorney.

[Endorsed]: Filed Nov. 24, 1950.

In the United States District Court
for the District of Oregon

Civil No. 5759

W. J. JONES & SON, INC.,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT

Comes now the plaintiff and for cause of action alleges:

I.

Plaintiff, W. J. Jones & Son, Inc., is a corporation duly organized and existing under the laws of the State of Oregon, maintaining its principal Office in Portland, Oregon, and brings this action to recover a refund of income taxes and excess profits taxes collected from plaintiff by the Collector of Internal Revenue for the District of Oregon.

II.

The taxes for which refund is herein sought were collected by J. W. Maloney who at all times herein concerned prior to September 1, 1947, was the duly appointed, qualified and acting Collector of Internal Revenue for the District of Oregon. Said J. W. Maloney was not in office as Collector of Internal Revenue for the District of Oregon when this action was commenced and has not been in such office

since September 1, 1947. Jurisdiction of this Court exists by virtue of 28 U.S.C. Section 1346.

III.

On or about March 15, 1949, plaintiff filed its income tax return for the calendar year 1948 in conformity with the Internal Revenue Code of the United States which return discloses a net operating loss of \$138,379.48.

IV.

Under Internal Revenue Code Sec. 122 plaintiff is entitled to carry-back to 1946 said 1948 operating loss of \$138,378.48, and the net operating loss deduction resulting from such carry-back completely absorbs all of plaintiff's 1946 net income entitling plaintiff to a refund of all the 1946 income taxes paid by plaintiff in the sum of \$12,190.32. Said 1946 income taxes in the sum of \$12,190.32, disclosed on the 1946 income tax return duly filed by plaintiff on or about March 15, 1947, were paid by plaintiff in installments of \$3,500.00 on March 14, 1947; \$3,500.00 on June 14, 1947, and \$5,190.32 on September 13, 1947. Refund is herein sought for the \$7,000.00 of said \$12,190.32 paid by plaintiff to J. W. Maloney, then Collector of Internal Revenue for the District of Oregon. Refund of the \$5,190.32 paid by plaintiff on September 13, 1947, is sought in an action against Hugh H. Earle, Collector of Internal Revenue, filed simultaneously with this complaint.

V.

Elimination of plaintiff's 1946 net income by the net operating loss deduction carried back from 1948 results in an unused excess profits credit which under the provisions of Sec. 122 of the Revenue Act of 1945 may be carried back from 1946 to 1944. Application of said unused excess profits credit adjustment against plaintiff's 1944 excess profits net income reduces plaintiff's 1944 income subject to excess profits tax and increases plaintiff's income subject to normal and surtax resulting in the overpayment by plaintiff of excess profits tax for 1944 in the amount of \$30,865.50 and producing a deficiency in 1944 normal and surtax in the amount of \$14,947.00, leaving a difference of \$15,918.50 for which refund is herein claimed. Excess profits taxes in the sum of \$49,871.47, disclosed on the 1944 return duly filed by plaintiff on or about March 15, 1945, were paid by plaintiff (less postwar credit) in installments on March 14, 1945; June 14, 1945; September 15, 1945, and December 14, 1945.

VI.

On or about November 2, 1949, plaintiff duly filed with the Collector of Internal Revenue for the District of Oregon a refund claim for income taxes paid for the calendar year 1946 in the amount of \$12,190.32 and a refund claim for \$30,865.50 of the excess profits taxes paid by plaintiff for the calendar year 1944. Said refund claims for 1946 and 1944 set forth the reasons for the allowance of said claims together with the computations of

the amounts thereof, and said refund claims for 1946 and 1944 hereto attached as Exhibits A and B, respectively, are incorporated herein by reference as though fully set forth in this complaint.

VII.

The net operating loss in the sum of \$138,379.48 disclosed by plaintiff's 1948 income tax return is the basis for substantially all the amount for which refund is herein sought. Of said \$138,379.48 net operating loss \$134,555.21 is a bad debt deduction under I.R.C. 23 (k).

VIII.

The 1948 bad debt deduction in the sum of \$134,555.21 is based upon the worthlessness of certain 6 per cent demand notes acquired by plaintiff in 1946 for the sum of \$121,763.74, the face amount of said notes plus accrued interest to the date of acquisition. The notes were issued by Mina del Refugio, a Mexican corporation at Hermosillo, Sonora, Mexico, to secure loans made to said corporation. Gold and silver mining operations carried on by said corporation were curtailed and finally terminated in the latter part of 1948 when the original veins of ore were unexpectedly exhausted and all attempts to discover additional ore were unsuccessful. At a meeting held on December 27, 1948, the board of directors of said corporation ratified the termination of all operations and confirmed the sale of all equipment pursuant to a contract previously entered into, and further directed the im-

mediate abandonment of all real property, mining claims and all other assets of said corporation including the corporate structure. At said meeting the directors determined that not more than \$22,500.00 could be salvaged from the corporation, and directed that any amount so realized should be distributed pro rata to the holders of the outstanding notes of the corporation. The notes owned by taxpayer for the indebtedness of \$121,763.74 constituted 39 per cent of the total indebtedness of \$308,378.39 secured by notes of said corporation. The pro rata distribution of said \$22,500.00 entitles the plaintiff to payment of an amount not in excess of \$8,775.00 (39 per cent of \$22,500) upon said indebtedness of \$121,763.74, leaving the debts totally worthless in the amount of \$112,988.74 (\$121,763.74 less \$8,775.00). While plaintiff held said notes it accrued interest thereon in the amount of \$21,566.47 which added to said sum of \$112,988.74 constitutes the bad debt deduction of \$134,555.21.

IX.

Said notes constituted valid debts of Mina del Refugio and were not subordinated to creditors, nor did said notes provide for payment only out of the earnings of said corporation. Shares of the common stock of Mina del Refugio were owned by persons other than those making loans to said corporation and it was the intention of parties concerned that the loans should be repaid to the lenders before any profits were distributed to the stockholders. Consequently stock could not have been issued in lieu of said notes.

X.

It was the intention of the parties concerned that said notes should constitute valid debts of Mina del Refugio and they were so treated by plaintiff and by said corporation. One indication of such intent is the fact that plaintiff accrued the interest upon said notes and plaintiff paid an income tax thereon.

XI.

The Commissioner of Internal Revenue has not mailed to plaintiff by registered mail any notice of the disallowance of said refund claims although plaintiff has received letters from the Internal Revenue Agent in Charge, Seattle, Washington, dated March 10, 1950, which propose substantial disallowance of said refund claims on the ground that the notes represent contributions to capital of Mina del Refugio rather than debts of said corporation. More than six months have elapsed since the filing of said refund claims by plaintiff.

Wherefore, plaintiff demands judgment against defendant for the sum of \$22,918.50, plus interest and costs, said sum of \$22,918.50 being \$7,000.00 for 1946 income taxes and \$15,918.50 for 1944 excess profits taxes (\$30,865.50 less \$14,947.00).

WILBUR, BECKETT, OPPEN-
HEIMER, MAUTZ & SOUTHER.

By /s/ WILLIAM H. KINSEY,
Attorneys for Plaintiff.

EXHIBIT A

Form 843

Treasury Department

Internal Revenue Service

CLAIM

To Be Filed With the Collector Where
Assessment Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse.

- ☐ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

Collector's Stamp (Date received):

State of Oregon,

County of Multnomah—ss.

Name of taxpayer or purchaser of stamps:

W. J. Jones & Son, Inc.

Business Address:

817 Board of Trade Bldg., Portland, Oregon.

Residence:

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed:
Oregon.
2. Period (if for tax reported on annual basis, prepare separate form for each taxable year): from Jan. 1, 1946, to Dec. 31, 1946.
3. Character of assessment or tax: Income taxes.
4. Amount of assessment, \$12,190.32; dates of payment, 1947.
5. Date stamps were purchased from the Government:
6. Amount to be refunded: \$12,190.32.
7. Amount to be abated (not applicable to income, gift, or estate taxes): \$.
8. The time within which this claim may be legally filed expires, under Section 322 of I.R.C., on March 15, 1952.

The deponent verily believes that this claim should be allowed for the following reasons:

1. Oregon excise tax of \$1,021.66 plus interest of \$71.52, a total of \$1,093.18, representing excise tax on 1946 income, was paid in 1948, and under the accrual method of accounting is deductible from 1946 income for Federal Income tax.

2. There is a net operating loss deduction attributable to the carry-back of a net operating loss sustained in 1948 that totally absorbs 1946 income, thereby reducing it to zero (see attached).

/s/

W. J. Jones & Son, Inc.
Portland, Oregon

Claim for Refund	Calendar Year 1946	
Net operating loss shown on 1948 Corporation Income tax return		\$138,379.48
Less: Contributions deducted on return not allowable under limitation of Sec. 23(q)		
I. R. C.		446.00
		<hr/>
Net operating loss shown on return, as adjusted..		\$137,933.48
Less: Adjustments required by Sec. 122(d),		
I. R. C.		—
		<hr/>
Statutory net operating loss for 1948		\$137,933.48
		<hr/>
Carry-back of 1948 net operating loss to 1946		\$137,933.48
Reduction under Sec. 122(c), I. R. C.		
Net income for 1946 disclosed by return		\$37,811.93
Less: Additional Oregon Excise Tax for 1946, paid in 1948, deductible in 1946 under accrual method of accounting	1,093.18	
		<hr/>
		\$36,718.75
Adjustments under Sec. 122 (d), I. R. C.		—
		<hr/>
Net income adjusted		\$36,718.75
Less: Normal tax income, shown by return....		\$37,811.93
Less: Additional Oregon Excise tax	1,093.18	36,718.75
		<hr/>
Excess of net income adjusted over normal tax net income		—
		<hr/>
Net operating loss deduction applicable to 1946		\$137,933.48
Less: 1946 net income adjusted.....		\$36,718.75
Plus: Contributions not deductible under the limitation of Sec. 23(q)		
I. R. C., after net operating loss deduction	1,135.00	37,853.75
		<hr/>
Net operating loss carry-back to 1947....		\$100,079.73

Net income shown on return	\$ 37,811.93
Less: Technical adjustment for addi- tional 1946 Oregon Excise tax.....	1,093.18
	<hr/>
Net income shown on return, as adjusted	\$ 36,718.75
Net operating loss deduction	137,933.48
	<hr/>
Net income adjusted	—
	<hr/>
Tax liability shown on return	\$ 12,190.32
Tax liability as adjusted	—
	<hr/>
Overassessment	\$ 12,190.32

EXHIBIT B

Form 843

Treasury Department

Internal Revenue Service

CLAIM

To Be Filed With the Collector Where
Assessment Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse.

- ☐ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

Collector's Stamp (Date received):

State of Oregon,
County of Multnomah—ss.

Name of taxpayer or purchaser of stamps:

W. J. Jones & Son, Inc.

Business address:

817 Board of Trade Bldg., Portland, Oregon.

Residence:

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed:
Oregon.
2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1944, to Dec. 31, 1944.
3. Character of assessment or tax: Excess Profits tax.
4. Amount of assessment, \$49,871.47; dates of payment, 1945.
5. Date stamps were purchased from the Government:
6. Amount to be refunded: \$30,865.50.
7. Amount to be abated (not applicable to income, gift, or estate taxes):
8. The time within which this claim may be legally filed expires, under Section 322 (b) of I.R.C., on March 15, 1952.

The deponent verily believes that this claim should be allowed for the following reasons:

The taxpayer reported on its Corporation Income Tax Return for the year 1946 a net income of \$37,811.93. The net income for the year 1946 was totally absorbed by a net operating loss deduction resulting from a net operating loss sustained for the year 1948. The 1946 net income as adjusted for the net operating loss deduction is zero and the taxpayer has available an unused excess profits credit of \$36,100.00 as computed by use of the income credit method (per RAR for 1944, dated January 22, 1948), which may be carried back from 1946 to 1944, under provision of Sec. 122 of the Revenue Act of 1945. The application of the unused excess profits credit adjustment against the 1944 excess profits net income results in the reduction of income subject to excess profits tax and the overpayment of excess profits tax for 1944 in the amount of \$30,865.50 (see attached).

/s/

W. J. Jones & Son, Inc.
Portland, Oregon

Claim for Refund

Calendar Year 1944

Computation of tax—1944

Declared value excess profits tax:

Computation as shown by RAR:

Net income for declared value excess
profits tax computation\$ 89,106.26

Less: 10% of \$750,000.00 value of
capital stock 75,000.00

Net income subject to declared value
excess profits tax\$ 14,106.26

Declared value excess profits tax 931.01

Computation as adjusted—no change 931.01

Difference

Income tax:

Computation as shown by RAR:

Net income for declared value excess
profits tax\$ 89,106.26

Add: net long-term capital gain 309.62

\$ 89,415.88

Less: Declared value excess profits
tax 931.01

Net income\$ 88,484.87

Less: Net long-term
capital gain\$ 309.62

Income subject to

excess profits
tax 42,075.25 42,384.87

Balance subject to normal
and surtax \$ 46,100.00

Normal tax \$ 10,791.00

Surtax 7,142.00

Partial tax\$ 17,933.00

25% of net long-term capital gain 77.41

Tax liability shown by RAR\$ 18,010.41

Computation as adjusted:

Net income	\$ 88,484.87	
Less: Net long-term capital gain	\$ 309.62	
Income subject to excess profits tax	5,975.25	6,284.87
Balance subject to normal and surtax		\$82,200.00
Normal tax (24%)		\$ 19,728.00
Surtax (16%)		13,152.00
Partial tax		\$ 32,880.00
25% of net long-term capital gain		77.41
		<u>\$32,957.41</u>

Deficiency in normal and surtax by reason of unused excess profits credit carry-back from 1946	\$ 14,947.00
--	--------------

Excess Profits Tax:

Computation as shown by RAR:

Excess profits net income	\$ 88,175.25	
Less: Specific exemption..	\$10,000.00	
Excess profits credit.....	36,100.00	
Unused excess profits credit adjustment	—	46,100.00
Adjusted excess profits net income..	\$42,075.25	
95% of adjusted excess profits net income		\$ 39,971.49
Less: Sec. 784 credit		3,997.15
Tax liability shown by RAR		<u>\$ 35,974.34</u>

Computation as adjusted:

Excess profits net income	\$ 88,175.25	
Less: Specific exemption..	\$10,000.00	
Excess profits credit....	36,100.00	
Unused excess profits credit adjustment (carry-back from 1946)	36,100.00	82,200.00
Adjusted excess profits net income	\$ 5,975.25	
95% of adjusted excess profits net income		\$ 5,676.49
Less: Sec. 784 credit		567.65
Tax liability as adjusted		<u>\$ 5,108.84</u>

Overassessment claimed by reason of unused excess profits credit carry-back from 1946	\$ 30,865.50
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Unused Excess Profits Credit

1945	Normal tax net income disclosed by return.....	\$37,811.93
	Less: Net operating loss deduction resulting from a net operating loss carry-back from 1948 (see schedule supra)	37,811.93
	Normal tax net income as adjusted	—
	Excess profits credit determined by the income credit method (as accepted by RAR dated January 22, 1948, for the year 1944-1945)....	\$36,100.00
	Excess profits net income—1946	—
	Unused excess profits credit carry-back to 1944..	\$36,100.00
1944	Net income—1944—as disclosed by RAR.....	\$88,484.87
	Less: excess of net long-term capital gain.....	309.62
		\$88,175.25
	Less: Income subject to excess profits tax as adjusted	5,975.25
	Balance subject to normal and surtax, as ad- justed	\$82,200.00
	Excess profits net income 1944 as disclosed by RAR	\$88,175.25
	Less: Specific exemption	\$10,000.00
	Unused excess profits credit (1946 carry-back)	36,100.00
	Excess profits credit, RAR	36,100.00
	Adjusted excess profits net income as adjusted..	\$ 5,975.25

State of Oregon,

County of Multnomah—ss.

I, Clayton R. Jones, being first duly sworn, depose and say that I am President of W. J. Jones & Son, Inc., plaintiff in the above-entitled action; and that the foregoing complaint is true as I verily believe.

/s/ CLAYTON R. JONES.

Subscribed and sworn to before me this 27th day of September, A.D. 1950.

[Seal]: /s/ WILLIAM H. KINSEY,
Notary Public for the State
of Oregon.

My Commission expires 12/21/52.

A True Copy.

[Endorsed]: Filed Sept. 27, 1950.

[Title of District Court and Cause.]

ANSWER

Defendant answers as follows:

I.

Admits the allegations contained in Paragraph I of the Complaint.

II.

Admits the allegations contained in Paragraph II of the Complaint.

III.

Denies all the allegations contained in Paragraph III of the Complaint except admits that on or about March 15, 1949, plaintiff filed its Income Tax Return for the Calendar Year 1948 in which there was disclosed an alleged operating loss in the amount of \$138,379.48.

IV.

Denies all of the allegations contained in Paragraph IV of the Complaint except admits that the

returned 1946 income taxes, in the alleged amount, were paid in installments on or about the dates alleged.

V.

Denies all of the allegations contained in Paragraph V of the Complaint except admits that the returned 1944 excess profits taxes were paid in installments on or about the dates alleged.

VI.

Denies all of the allegations contained in Paragraph VI of the Complaint except admits that plaintiff filed with the Collector of Internal Revenue for the District of Oregon on November 4, 1949, an instrument in writing purporting to be a claim for refund for the calendar year 1946, in the amount of \$12,190.32, and on the same date filed with the Collector of Internal Revenue for the District of Oregon, an instrument in writing purporting to be a claim for refund for the calendar year 1944, in the amount of \$30,865.50, and admits that Exhibits "A" and "B" to the complaint are true copies of the purported claims for refund.

VII.

Denies all of the allegations contained in Paragraph VII of the Complaint.

VIII.

Defendant specifically denies that plaintiff is entitled to a bad debt deduction in the amount alleged, or in any other amount. Further answering the

allegations of Paragraph VIII of the Complaint, defendant avers that it is without knowledge or information sufficient to form a belief as to the truth of any of the remaining allegations contained in that paragraph.

IX.

Denies all of the allegations contained in Paragraph IX of the Complaint.

X.

Denies all of the allegations contained in Paragraph X of the Complaint.

XI.

Admits the allegations contained in Paragraph XI of the Complaint.

Wherefore, having fully answered, defendant prays judgment and costs.

HENRY L. HESS,

United States Attorney for
the District of Oregon;

/s/ DONALD W. McEWEN,

Assistant United States
Attorney.

United States of America,
District of Oregon—ss.

I, Donald W. McEwen, hereby certify that I have made service of the foregoing Answer on the plaintiff herein by depositing a duly certified copy thereof in the U. S. Post Office at Portland, Oregon,

on November 24, 1950, said copy being enclosed in an envelope with postage thereon prepaid addressed to Messrs. Wilbur, Beckett, Oppenheimer, Mautz & Souther; William H. Kinsey, Attorneys at Law, 1001 Board of Trade Bldg., Portland 4, Oregon, attorneys of record for plaintiff herein.

/s/ DONALD W. McEWEN,
Of Attorneys for Defendant.

[Endorsed]: Filed Nov. 24, 1950.

[Title of District Court and Causes.]

Civil Nos. 5758 and 5759

PRE-TRIAL ORDER

Introductory Statements

On the 9th day of April, 1951, a pre-trial conference was held in open court, the Honorable Gus J. Solomon of this court presiding. The plaintiff in each of the above-entitled actions appeared by its attorneys, Eugene K. Oppenheimer and William H. Kinsey (Wilbur, Beckett, Oppenheimer, Mautz & Souther), and the defendant in each of the above-entitled actions was represented and appeared by Thomas R. Winter, a special assistant to the chief counsel of the Bureau of Internal Revenue.

The two above-entitled actions involve the same controversy and have been divided into two complaints by plaintiff only for pleading and jurisdiction purposes. The two actions will be consolidated

for trial and are herein considered as one action against the defendants collectively.

This is an action to recover excess profits taxes paid by plaintiff for the year 1944 and income taxes paid by plaintiff for the years 1946 and 1947. While the action technically involves the years 1944, 1946 and 1947, the real basis of the controversy is an alleged 1948 bad debt deduction in the sum of \$134,555.21 claimed by plaintiff as the major portion of an alleged net operating loss disclosed on its 1948 income tax return. Defendants have denied the said 1948 bad debt deduction and the resulting portion of the 1948 net operating loss. If such 1948 bad debt deduction is allowable as claimed by plaintiff, it increases plaintiff's 1948 net operating loss by the amount of said deuction, and such net operating loss may be carried back and reflected in the years 1944, 1946 and 1947, entitling plaintiff to an excess profits tax refund for 1944 and income tax refunds for 1946 and 1947. Plaintiff's claimed bad debt deduction in the sum of \$134,555.21 is based upon the claimed worthlessness of certain notes held by plaintiff which were issued by Mina del Refugio, S. A., a Mexican corporation.

Statement of Facts Admitted Upon the
Pleadings and at Pre-Trial

I.

At all times herein concerned plaintiff has been and now is a corporation duly organized and existing under the laws of the State of Oregon, maintaining its principal office in Portland, Oregon.

II.

The taxes for which refund is sought in Civil No. 5759 (against the United States) were collected by J. W. Maloney, who at all times herein concerned prior to September 1, 1947, was the duly appointed, qualified and acting Collector of Internal Revenue for the District of Oregon, and was not in office as Collector of Internal Revenue for the District of Oregon when this action was commenced and has not been in such office since September 1, 1947. The taxes for which refund is sought in Civil No. 5758 (against the Collector) were collected by Hugh H. Earle, who at all times herein concerned on and subsequent to September 1, 1947, was, and now is, the duly appointed and acting Collector of Internal Revenue for the District of Oregon.

III.

Jurisdiction of this Court over Civil No. 5758 (against the Collector) exists by virtue of 28 U.S.C. Sec. 1340, and jurisdiction of this Court over Civil No. 5759 (against the United States) exists by virtue of 28 U.S.C. Sec. 1346.

IV.

On or about March 15, 1949, plaintiff filed its income tax return for the calendar year 1948 (Pre-Trial Exhibit No. 1), in which there was disclosed an alleged bad debt deduction of \$134,555.21, constituting part of an alleged operating loss in the amount of \$138,379.48.

V.

On or about May 16, 1947, plaintiff filed its completed income tax return for 1946 (Pre-Trial Exhibit No. 2), disclosing an income tax liability of \$12,190.32, which sum plaintiff duly paid in installments during 1947.

VI.

On or about May 17, 1948, plaintiff filed its completed income tax return for the year 1947 (Pre-Trial Exhibit No. 3), disclosing an income tax liability of \$154,791.75, which sum plaintiff duly paid in installments during the year 1948.

VII.

On or about April 20, 1945, plaintiff duly filed its completed income tax return (Pre-Trial Exhibit No. 4) and excess profits tax return (Pre-Trial Exhibit No. 5) for the year 1944, disclosing an income tax liability of \$19,677.81 and an excess profits tax liability of \$49,871.47, which taxes plaintiff duly paid in installments during the year 1945.

VIII.

On November 4, 1949, plaintiff timely filed with the Collector of Internal Revenue for the District of Oregon a refund claim on Form 843 for the calendar year 1946 (Pre-Trial Exhibit 6) in which plaintiff claims a refund of \$12,190.32, being all of the income tax paid by plaintiff for the calendar year 1946. Substantially all of such refund for 1946 claimed by plaintiff results from an alleged net operating loss deduction attributable to the carry-

back of the alleged net operating loss claimed in 1948.

IX.

On November 4, 1949, plaintiff timely filed with the Collector of Internal Revenue for the District of Oregon a refund claim on Form 843 for the year 1947 (Pre-Trial Exhibit 7), in which plaintiff claims a refund of \$38,030.29 of the income taxes paid by plaintiff for the calendar year 1947. All of such refund for 1947 claimed by plaintiff results from an alleged net operating loss deduction attributable to the carry-back to 1946 of the alleged net operating loss claimed in 1948 and the carry-forward from 1946 to 1947 of the amount of the alleged net operating loss deduction not absorbed by 1946 net income.

X.

On November 4, 1949, plaintiff timely filed with the Collector of Internal Revenue for the District of Oregon a refund claim on Form 843 for the year 1944 (Pre-Trial Exhibit 8), in which plaintiff claims a refund of excess profits taxes in the sum of \$30,865.50. Said refund is based on an alleged unused excess profits credit carried back from 1946 to 1944, which 1946 excess profits credit results from the elimination of plaintiff's 1946 income by the alleged 1946 net operating loss deduction attributable to the carry-back of the alleged net operating loss claimed in 1948. Said refund claim indicates that the claimed excess profits tax refund results in an income tax deficiency of \$14,947.00 and that the difference between the claimed excess profits tax

refund and the resulting income tax deficiency is \$15,918.50.

XI.

Plaintiff has not received by registered mail from defendants, or either of them, or from the Commissioner of Internal Revenue, any notice of allowance or disallowance of said refund claims for 1944, 1946 and 1947, and more than six months have elapsed since the filing of said refund claims by plaintiff.

XII.

At all times herein concerned Mina del Refugio, S.A., was a corporation duly organized and existing under the laws of Mexico.

XIII.

As of December 31, 1948, plaintiff charged off on its books the sum of \$134,555.21 by: (a) debiting "bad debts" in the amount of \$143,330.21, and (B) crediting "notes receivable" in the amount of \$121,763.74, (c) crediting "interest" in the sum of \$21,566.47, and (d) setting up on its books \$8,655.00 as the estimated amount of recovery on alleged notes of Mina del Refugio, S.A.

Plaintiff's Statement of Facts

Denied by Defendants

Set forth below is plaintiff's statement of facts giving rise to, and forming the basis for, the claimed 1948 bad debt deduction in the sum of \$134,555.21. Defendants deny the facts herein stated.

I.

During the year 1948 plaintiff was the holder and owner of 32 promissory notes in the aggregate principal amount of \$121,763.74 duly issued by Mina del Refugio, S.A., a Mexican corporation (hereinafter called the "Mexican corporation") which notes are dated on various dates commencing November 30, 1944, and ending December 30, 1946, payable two years after the date of issue together with interest at the rate of 6 per cent per annum from the dates of the notes or from a prior date specified in the notes. On or about August 31, 1946, plaintiff received 28 of said 32 notes in the aggregate principal amount of \$102,930.96 by endorsement without recourse from Clayton R. Jones, and plaintiff paid value for said 28 notes by crediting the account of Clayton R. Jones in the sum of \$102,930.96, the face amount of said notes, and the sum of \$4,654.57 as interest accrued on said notes to August 31, 1946, making a total credit of \$107,585.53 to the account of Clayton R. Jones. The other 4 notes in the aggregate face amount of \$18,832.78 were received by plaintiff on December 31, 1946, by endorsement without recourse from Clayton R. Jones, and plaintiff paid value from said notes by crediting the account of Clayton R. Jones in the sum of \$18,832.78, the face amount of said 4 notes. The aggregate sum in which plaintiff credited the account of Clayton R. Jones in payment for said 32 notes was \$126,418.31, being the \$102,930.96 principal amount of the 28 notes received on August 31, 1946, \$4,654.57 accrued interest

on said notes to August 31, 1946, plus \$18,832.78 principal amount of the four notes received by plaintiff on December 31, 1946. Such credits made by plaintiff to the account of Clayton R. Jones cancelled and paid \$126,418.31 of a debt owed by Clayton R. Jones to plaintiff for cash advances made by plaintiff to or on behalf of Clayton R. Jones.

II.

After receipt of said notes from Clayton R. Jones, plaintiff accrued interest on said notes in the sum of \$2,300.22 for 1946, \$7,305.84 for 1947, and \$7,305.84 for 1948, making total accrued interest of \$16,911.90. Such accrued interest was reflected in plaintiff's net income for federal income tax purposes for the subject years. Such \$16,911.90 in accrued interest, plus the \$126,418.31 with which plaintiff credited the account of Clayton R. Jones in payment for said notes, made a total of \$143,330.21 which plaintiff paid or accrued for said 32 notes.

III.

The Board of Directors of the Mexican corporation, debtor on said 32 notes, held a meeting on December 27, 1948, at which the Board ratified the termination of all operations of the Mexican corporation and confirmed the sale of all equipment of the corporation pursuant to a contract previously entered into, and further directed the immediate abandonment of all real property, mining claims and all other assets of the corporation, including the corporate structure, and at said meeting the

directors determined that not more than \$22,500.00 could be salvaged from the corporation, and directed that any amount so realized should be distributed pro rata to the holders of the outstanding notes of the corporation.

IV.

Said 32 notes owned by plaintiff constituted 39 per cent of the notes of the Mexican corporation outstanding in the total sum of \$308,378.39, so that a pro rata distribution of said \$22,500.00 entitled plaintiff to payment of an amount not in excess of \$8,775.00 (39% of \$22,500.00) upon its notes. Said notes were partially worthless if not wholly worthless in 1948 to the extent of \$134,555.21, being the difference between \$143,330.21 (the amount paid and accrued by plaintiff for the notes) and \$8,775.00 (the maximum pro rata distribution to which plaintiff was entitled on said notes). Plaintiff was justified in charging off said notes in 1948 in the sum of \$134,555.21 and the amount actually received by plaintiff on said notes subsequent to such charge-off was \$8,694.42, which is \$80.58 less than the \$8,775.00 set up by plaintiff on its books as the estimated recovery when the notes were charged off on December 31, 1948.

Contentions of Plaintiff

That plaintiff is entitled to its claimed 1948 bad debt deduction of \$134,555.21 (and resulting net operating loss) attributable to ownership of certain notes of Mina del Refugio, S.A., a Mexican corporation, because:

(1) The notes of said Mexican corporation owned and charged off by plaintiff in 1948 were debt obligations within the meaning of I.R.C. Sec. 23 (k).

(2) Plaintiff paid and accrued the aggregate sum of \$143,330.21 for said notes.

(3) Said notes became worthless in 1948 to the extent of \$134,555.21, said sum being the \$143,330.21 paid or accrued by plaintiff for the notes less the \$8,775.00 maximum recovery to which plaintiff was entitled on the notes after termination of the debtor's activities in 1948. If said notes were not worthless to the extent of \$134,555.21 in 1948, they were recoverable only in part within the meaning of the provision of Section 23 (k) (1), which reads: " * * * when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction," and plaintiff charged off said notes in 1948 in the amount of \$134,555.21.

Contentions of Defendants

That the Commissioner of Internal Revenue did not err in denying the plaintiff's claimed bad debt deduction of \$134,555.21 attributable to ownership of certain notes of the Mina del Refugio, a Mexican mining corporation, because

1. The plaintiff's investment in Mina del Refugio was not in truth and in fact loans, the loss

on which would be deductible under Section 23 (k) of the Internal Revenue Code as "a debt recoverable only in part,"

2. The advancements were properly considered by the Commissioner as contributions of capital and not debts within the meaning of Section 23 (k), and

3. The burden is upon the plaintiff to prove that the loss, if any, on its investment in Mina del Refugio was sustained in 1948.

Issue to Be Decided

Whether the sum of \$134,555.21 of the claimed net operating loss of \$138,379.48 reported by plaintiff in its 1948 income tax return was a bad debt allowable as a deduction for 1948 under Section 23 (k) of the Internal Revenue Code.

Plaintiff contends and defendants concede that if the said \$134,555.21 is allowable as a bad debt deduction for 1948 under I.R.C. Section 23 (k), then plaintiff is entitled to its claimed net operating loss for 1948 and to refunds for 1944, 1946 and 1947, which refunds result from (i) the carry-back of such net operating loss to 1946 and 1947 under Section 122 of the Internal Revenue Code, and (ii) the unused excess profits credit created by the carry-back of such net operating loss to 1946 which excess profits credit may be carried back to 1944 under the provisions of I.R.C. Section 710 (c) as amended by Section 122 (c) of the Revenue Act of 1945. Defendants do not admit that such carry-backs and unused excess profits credit generates the exact

amount of the refunds claimed by plaintiff, as there may be certain minor adjustments. If this court decides the above issue in favor of plaintiff the parties will be able to compute the amount of the refunds to which plaintiff is entitled for 1944, 1946 and 1947.

Exhibits

The following exhibits were introduced by plaintiff at the pre-trial conference and were marked for identification and it was stipulated that further identification or authentication be waived, irrespective of whether said exhibits are originals, copies or translations, each party reserving, however, the right to object to the admissibility of said exhibits on the ground of relevancy and materiality only:

1. Plaintiff's Income Tax Return for the calendar year 1948.
2. Plaintiff's Income Tax Return for the calendar year 1946.
3. Plaintiff's Income Tax Return for the calendar year 1947.
4. Plaintiff's Income Tax Return for the calendar year 1944.
5. Plaintiff's Excess Profits Tax Return for the calendar year 1944.
6. Plaintiff's 1946 Refund Claim.
7. Plaintiff's 1947 Refund Claim.
8. Plaintiff's 1944 Refund Claim.
9. Revenue Agent's report on examination of plaintiff's 1946 refund claim and on examination of 1948 bad debt deduction.

10. Revenue Agent's report on examination of plaintiff's 1947 refund claim.

11. Revenue Agent's report on examination of plaintiff's 1944 refund claim.

12. Revised statement on Revenue Agent's report covering examination of 1946 return of Clayton R. Jones.

13 through 44. 32 promissory notes of Mina del Refugio, S.A., payable to Clayton R. Jones, dated various dates from November 30, 1944, to December 30, 1946, aggregating \$121,763.74. (The individual notes have been separately numbered 13 to 44, inclusive.)

45. Articles of Incorporation and Bylaws of Mina del Refugio, S.A., in Spanish, certified by the consul of the United States at Nogales, Sonora, Mexico.

46. Certified translation of the Articles of Incorporation and Bylaws identified in Exhibit 45.

47. Original minute book of Mina del Refugio, S.A., in longhand and in Spanish.

48. Translation of the minute book identified in Exhibit 47.

49. Stock book of Mina del Refugio, S.A.

50. Book of Mina del Refugio, S.A., containing record of cash received, check record and journal entries.

51. General ledger of Mina del Refugio, S.A.

52. Letter dated June 30, 1944, from D. D. Kroder to Clayton R. Jones.

53. Mining option agreement dated July 31,

1944, between Clayton R. Jones, John C. Higgins and Daniel Kroder.

54. Supplemental agreement dated August 31, 1944, between Kroder, Jones and Higgins, and related letter from Higgins to Kroder dated August 31, 1944.

55. Trust agreement dated September 1, 1944, between Clayton R. Jones, John C. Higgins and D. E. Harris with attached letter from Juan F. Robinson to D. E. Harris dated August 10, 1944.

56. Translation of option and lease agreement dated October 31, 1944, from Jorge F. Robinson, Juan F. Robinson and Ana Robinson to Mina del Refugio, S.A.

57. Agreement dated November 20, 1944, between Clayton R. Jones, D. E. Harris and John C. Higgins.

58. Copy of the minutes of the meeting of the Board of Directors of Mina del Refugio, S.A., dated November 20, 1944.

59. Agreement dated March, 1945, between Clayton R. Jones, John C. Higgins and D. E. Harris.

60. Letter dated April 17, 1945, from Walter M. Wells to Clayton Jones.

61. Letter dated July 29, 1945, from A. J. Klamt to Higgins and Jones.

62. Letter dated March 21, 1946, from John C. Higgins to Malcolm C. Little.

63. Letter dated March 25, 1946, from John C. Higgins to Arthur E. Johnson.

64. Letter dated May 16, 1946, from Clayton R. Jones to Walter Wells.

65. Journal entry sheet of plaintiff for August 31, 1946.

66. Journal entry sheet of plaintiff for December 31, 1946.

67. Account sheet of Clayton R. Jones with plaintiff for 1946.

68. Letter dated April 4, 1947, from Clayton R. Jones to Walter M. Wells.

69. Letter dated August 4, 1947, from John C. Higgins to Juan F. Robinson.

70. Letter dated January 15, 1948, from A. J. Klamt to John C. Higgins.

71. Letter dated March 9, 1948, from Clayton R. Jones to Walter M. Wells.

72. Letter dated April 1, 1948, from A. J. Klamt to Mina del Refugio, Portland, Oregon.

73. Letter dated April 8, 1948, from Clayton R. Jones to A. J. Klamt.

74. Telegram dated November 15, 1948, from Clayton R. Jones to A. J. Klamt.

75. Two letters dated December 27, 1948, from John C. Higgins to A. J. Klamt.

76. Copy of minutes of meeting of the Board of Directors of Mina del Refugio, S.A., held on December 27, 1948.

77. Statement dated December 27, 1948, signed by A. J. Klamt.

78. Journal entry sheets of plaintiff for December 31, 1948.

79. Various journal entry sheets and account sheets of plaintiff showing accrual of interest on Mina del Refugio, S.A., notes.

80. Internal Revenue Agent in charge, etc.

[In margin: To W. J. Jones & Son, Inc., enclosing copy of Revenue Agent's Report of January 27, 1950, for the years 1946 and 1948.]

It is agreed by the parties that this pre-trial order will govern the course of the trial and will not be amended, except by consent, or to prevent manifest injustice.

The court finding that the foregoing clearly and accurately reflects the pre-trial conference and the stipulations and agreements of the parties, hereby ratifies and confirms the foregoing proceedings, and does hereby

Order that the said pre-trial order be and the same is hereby incorporated into and hereby made a part of the record in this case for the purpose of controlling the course of proceedings on the formal trial hereof before the Court.

Dated this 7th day of May, 1951.

/s/ GUS J. SOLOMON,
Judge.

Approved:

/s/ WILLIAM H. KINSEY,
Of Attorneys for Plaintiff.

/s/ THOMAS R. WINTER,
Of Attorneys for Defendant.

[Endorsed]: Filed May 7, 1951.

In the United States District Court
for the District of Oregon

Civil No. 5758

W. J. JONES & SON, INC.,

Plaintiff,

vs.

HUGH H. EARLE, Collector of Internal Revenue
for the District of Oregon,

Defendant.

Civil No. 5759

W. J. JONES & SON, INC.,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT

The above-entitled cases were consolidated by consent of the parties and approval of the Court, and came on regularly for trial without a jury before the Honorable Claude C. McColloch, Judge of the above-entitled Court, on May 15 and 16, 1951.

Plaintiff appeared by its president, Clayton R. Jones, and its attorneys, Eugene K. Oppenheimer and William H. Kinsey (Wilbur, Oppenheimer, Mautz & Souther), and defendants were represented and appeared by Andrew F. Oehmann, Special Assistant to the Attorney General, and Donald W.

McEwen, Assistant United States Attorney for the District of Oregon.

Following opening statements of counsel, the evidence of plaintiff and defendants was presented. After both parties rested, arguments of counsel were heard and the Court took the matters under advisement. Thereafter the Court, being fully advised, announced judgment for the plaintiff in each of the above-entitled cases, and in accordance therewith the Court hereby makes the following findings of fact and conclusions of law, and the exhibits referred to in the findings are by such reference made a part thereof as though fully set forth therein:

Findings of Fact

I.

At all times herein concerned plaintiff was and now is a corporation duly organized and existing under and by virtue of the laws of the State of Oregon, maintaining its principal office in Portland, Oregon.

II.

The taxes for which refund is sought in Civil No. 5759 (against the United States) were collected by J. W. Maloney, who prior to September 1, 1947, was the duly appointed, qualified and acting Collector of Internal Revenue for the District of Oregon, and was not in office as Collector of Internal Revenue for the District of Oregon when said action was commenced and has not been in such office since September 1, 1947. The taxes for which refund is

sought in Civil No. 5758 (against the Collector) were collected by Hugh H. Earle, who subsequent to September 1, 1947, was, and now is, the duly appointed, qualified and acting Collector of Internal Revenue for the District of Oregon.

III.

Jurisdiction of this Court over Civil No. 5758 (against the Collector) exists by virtue of 28 U.S.C. Sec. 1340, and jurisdiction of this Court over Civil No. 5759 (against the United States) exists by virtue of 28 U.S.C. Sec. 1346.

IV.

On or about March 15, 1949, plaintiff duly filed its income tax return for the calendar year 1948 (Exhibit No. 1) wherein plaintiff properly claimed a bad debt deduction of \$134,555.21 which constituted part of an operating loss for 1948 in the amount of \$138,379.48.

V.

On or about May 16, 1947, plaintiff duly filed its completed income tax return for 1946 (Exhibit No. 2), which properly disclosed an income tax liability of \$12,190.32, and plaintiff duly paid said tax in installments during 1947.

VI.

On or about May 17, 1948, plaintiff duly filed its completed income tax return for the year 1947 (Exhibit No. 3), which properly disclosed an income tax liability of \$154,791.75, and plaintiff duly paid said tax in installments during the year 1948.

VII.

On or about April 20, 1945, plaintiff duly filed its completed income tax return (Exhibit No. 4) and excess profits tax return (Exhibit No. 5) for the year 1944, which properly disclosed an income tax liability of \$19,677.81 and an excess profits tax liability of \$49,871.47, and plaintiff duly paid said taxes in installments during the year 1945.

VIII.

On November 4, 1949, plaintiff duly filed with the Collector of Internal Revenue for the District of Oregon a refund claim on Form 843 for the calendar year 1946 (Exhibit No. 6), in which plaintiff properly claimed a refund of \$12,190.32, resulting primarily from a net operating loss deduction attributable to the carry-back to 1946 of the \$138,379.48 net operating loss sustained in 1948.

IX.

On November 4, 1949, plaintiff duly filed with the Collector of Internal Revenue for the District of Oregon a refund claim on Form 843 for the year 1947 (Exhibit No. 7), in which plaintiff properly claimed a refund of \$38,030.29 resulting from a net operating loss deduction attributable to the carry-back to 1946 of the \$138,379.48 net operating loss sustained in 1948 and the carry-forward from 1946 to 1947 of the amount of such net operating loss deduction not absorbed by 1946 net income.

X.

On November 4, 1949, plaintiff duly filed with the Collector of Internal Revenue for the District of Oregon a refund claim on Form 843 for the year 1944 (Exhibit No. 8), in which plaintiff properly claimed a refund of excess profits taxes in the sum of \$30,865.50 resulting from an unused excess profits credit carried back from 1946 to 1944, due to the elimination of plaintiff's 1946 income by the 1946 net operating loss deductions attributable to the carry-back of the \$138,379.48 net operating loss sustained in 1948. Said refund claim disclosed that said unused excess profits credit carry-back results in an income tax deficiency of \$14,947.00.

XI.

Plaintiff did not receive by registered mail any notice of allowance or disallowance of said refund claim for 1944, 1946 and 1947, and the within actions were not commenced until more than six months had elapsed after the aforementioned filing of said refund claims by plaintiff.

XII.

At all times herein concerned Mina del Refugio, S.A., was a corporation duly organized and existing under and by virtue of the laws of Mexico. Said corporation is hereinafter referred to as the "Mexican Corporation."

XIII.

Plaintiff's accounting period is the calendar year and plaintiff keeps its books on the accrual basis.

XIV.

During the year 1948 plaintiff was the unqualified holder and owner of 32 promissory notes in the aggregate principal amount of \$121,763.74 (Exhibits 13 through 44), duly issued by the Mexican Corporation.

XV.

Defendants admit and the Court finds that said 32 notes were acquired by plaintiff for a valuable consideration.

XVI.

On or about August 31, 1946, plaintiff received 28 of said 32 notes from Clayton R. Jones for a valuable consideration equal to their aggregate principal amount of \$102,930.96, plus \$4,654.57 accrued interest thereon to August 31, 1946. The remaining 4 notes of said 32 notes were received by plaintiff from Clayton R. Jones on December 31, 1946, for a valuable consideration equal to their aggregate principal amount of \$18,832.78, making a total consideration of \$126,418.31 paid by plaintiff for said 32 notes.

XVII.

When said 32 notes were received by plaintiff on August 31, 1946, and December 31, 1946, for the aggregate consideration of \$126,418.31, said notes were reasonably worth such consideration paid for same, and plaintiff and the officers of the Mexican Corporation fully expected that said notes and interest would be fully paid.

XVIII.

After receipt of said notes from Clayton R. Jones, plaintiff accrued interest on said notes in the sum of \$2,300.22 for 1946, \$7,305.84 for 1947, and \$7,305.84 for 1948, making total accrued interest of \$16,911.90. Such accrued interest was reflected in plaintiff's net income for federal income tax purposes for the subject years. Said \$16,911.90 is accrued interest, plus the aforementioned aggregate consideration of \$126,418.31, made a total of \$143,330.21 which plaintiff paid or accrued for said 32 notes.

XIX.

The Board of Directors of the Mexican Corporation duly held a meeting on December 27, 1948, at which the board ratified the termination of all operations of the Mexican Corporation, confirmed the sale of all its equipment and further directed the immediate abandonment of all real property, mining claims and other assets. At said meeting the directors determined that not more than \$22,500.00 could be salvaged from all of the corporate assets.

XX.

Said 32 notes were worthless in 1948 to the extent of \$134,555.21, said amount being the difference between \$143,330.21 (the consideration paid and accrued by plaintiff for said notes) and \$8,775.00 (the maximum amount which plaintiff could expect to recover on said notes); and on December 31, 1948, plaintiff properly charged said notes off on its books in the sum of \$134,555.21 by (a) debiting

“bad debts” in the amount of \$143,330.21, (b) crediting “notes receivable” in the amount of \$121,763.74, (c) crediting “interest” in the sum of \$21,566.47, and (d) setting up on its books \$8,775.00 as the estimated amount of recovery on said notes. The amount actually received by plaintiff on said notes subsequent to such charge-off was \$8,694.42, which is \$80.58 less than \$8,775.00 estimated recovery.

XXI.

Said 32 notes charged off by plaintiff in 1948 were not worthless prior to 1948.

XXII.

At no time during 1948 nor at any other time did plaintiff own any capital stock or any other equity interest in the Mexican Corporation.

XXIII.

Clayton R. Jones made loans to the Mexican Corporation evidenced by notes duly issued for a valuable consideration, and 32 of the notes so issued to Clayton R. Jones were the 32 notes assigned by him to plaintiff for value on August 31, 1946, and December 31, 1946.

XXIV.

In addition to the loans to the Mexican Corporation made by Clayton R. Jones, loans were made by John C. Higgins and D. E. Harris, which loans were also evidenced by notes duly issued by the Mexican Corporation for a valuable consideration.

XXV.

Advances in the aggregate sum of \$308,378.39 were made by Clayton R. Jones, John C. Higgins and D. E. Harris, which advances were evidenced by notes duly made, executed and delivered by the Mexican Corporation (including the 32 notes assigned by Clayton R. Jones to plaintiff for value). At the time of making such advances Jones, Higgins and Harris intended that the advances should constitute loans and create a debtor-creditor relationship, and all subsequent actions of Jones, Higgins and Harris in regard to said advances (and the notes evidencing same) have been consistent with such intention that said advances constituted loans and created a debtor-creditor relationship.

XXVI.

Jones, Higgins and Harris acquired the Mexican Corporation for the purpose of exploiting certain gold and silver mining rights having a substantial value obtained by Jones, Higgins and Harris as individuals from two finders named Daniel D. Kroder and Arthur E. Johnson.

XXVII.

Pursuant to an agreement dated July 31, 1944 (Exhibit 53), Kroder was to receive one-third stock interest in the Mexican Corporation as a finder's fee for procuring such mining rights for Jones, Higgins and Harris, which interest was later reduced to a 20 per cent stock interest to Kroder and his associate Johnson (10% to each) under a sup-

plemental agreement of August 31, 1944 (Exhibit 54). Kroder and Johnson never made any advances or contributions to the Mexican Corporation. The 80 per cent balance of the capital stock of the Mexican Corporation was owned by Jones, Higgins and Harris.

XXVIII.

The mining rights acquired by Jones, Higgins and Harris from Kroder and Johnson were transferred by Jones, Higgins and Harris to the Mexican Corporation through the execution of an option and lease agreement dated October 31, 1944, in the name of the Mexican Corporation (Exhibit 56). Said mining rights at the time of such transfer to the Mexican Corporation had a very substantial value in excess of the amount payable under said option and lease agreement, and such transfer of said mining rights to the Mexican Corporation by Jones, Higgins and Harris constituted contributions to the capital of the Mexican Corporation.

XXIX.

In the spring of 1945 a third person, Walter M. Wells, and his associates paid \$5,000 for the 10 per cent stock interest of Kroder in the Mexican Corporation, and in March, 1946, Jones and Higgins paid \$4,000 for the 9 per cent stock interest of Johnson in the Mexican Corporation (Johnson previously having transferred a one per cent interest to an associate of Wells). The asset accounting for such value of the stock was the excess in the

value of said mining rights over the amounts payable under the option and lease agreement.

XXX.

Whether or not the transfer of said mining rights by Jones, Higgins and Harris to the Mexican Corporation constituted contributions to capital, the advances made by Jones, Higgins and Harris to the Mexican Corporation evidenced by the notes duly issued by the Mexican Corporation (including the 32 notes in question) were intended to constitute, and did constitute, loans rather than contributions to capital.

XXXI.

The advances to the Mexican Corporation were not made by the stockholders thereof in direct proportion to their stock ownership because Kroder and Johnson owned 20 per cent of the capital stock but made no advances whatsoever to the corporation.

XXXII.

There were business reasons why Jones, Higgins and Harris intended that their advances to the Mexican Corporation should constitute loans, in that they desired to be repaid such advances before anything was received by or accrued to the finders (Kroder and Johnson), who paid nothing for their 20 per cent stock interest, and they desired to be in as strong a position as possible in the event that the Mexican authorities or general creditors made claims against the corporation.

XXXIII.

At the time of the execution of the agreements under which the loans were made to the Mexican Corporation (Exhibits 53, 57 and 59), Jones, Higgins and Harris expected that the advances required by the corporation would not exceed \$50,000, and had no idea that the advances would exceed \$300,000. They believed that the loans would be repaid prior to the maturity dates of the notes issued for such loans and based on their investigations, available engineering reports and blocked-out ore deposits, such belief was reasonable. The liabilities evidenced by the notes of the Mexican Corporation were agreed to be incurred by Jones, Higgins and Harris in the expectancy that the Mexican Corporation would be successful and pay off the obligations.

XXXIV.

The loans evidenced by the 32 notes charged off by plaintiff in 1948 were consistently treated as loans and debt obligations on the books of plaintiff and on the books of the Mexican Corporation.

Conclusions of Law

I.

The Court has jurisdiction of the parties and the subject matter.

II.

That \$134,555.21 of the \$138,379.48 net operating loss sustained by plaintiff for its taxable year 1948 was a bad debt allowable as a deduction for 1948 under Section 23 (k) of the Internal Revenue Code,

and such \$138,379.48 net operating loss entitled plaintiff to the refunds claimed by it for 1944, 1946 and 1947.

III.

Said 1948 bad debt deduction of \$134,555.21 resulted from the worthlessness of 32 notes of the Mexican Corporation owned by plaintiff in 1948, which notes constituted debt obligations within the meaning of I.R.C. Section 23 (k), and said notes had an adjusted basis to plaintiff of \$143,330.21. Said 32 notes became worthless in 1948 to the extent of at least \$134,555.21, and plaintiff properly charged said notes off on its books in 1948 in the amount of \$134,555.21.

IV.

Plaintiff is entitled to recognition for tax purposes as a separate entity distinct from Clayton R. Jones, who assigned the 32 notes in question to plaintiff for a valuable consideration. Said 32 notes in the hands of plaintiff constituted debt obligations and did not represent contributions to capital, because: (i) said notes were in the form of debt obligations, (ii) said notes were received by plaintiff as debt obligations for value, (iii) said notes were consistently treated by plaintiff as debt obligations, and (iv) plaintiff did not have or own any interest in the capital stock of the Mexican Corporation, and the stock ownership of Clayton R. Jones in the Mexican Corporation, or his activities in regard thereto, are not attributable to plaintiff.

V.

To determine whether advances in any particular instance should be regarded for tax purposes as constituting debts or contributions to capital it is necessary to consider all the circumstances, including the intent of the parties at the time the transactions in question were entered into, and if the stock ownership of Clayton R. Jones in the Mexican Corporation, or his activities in regard thereto, are attributable to plaintiff, then findings of fact XXIII through XXXIV support the Court's conclusion that \$134,555.21 of plaintiff's \$138,379.48 net operating loss for 1948 was a bad debt allowable as a deduction for 1948 under I.R.C. Section 23 (k).

VI.

The taxes for which refund is herein sought were excessive, and were illegally and wrongfully withheld from plaintiff, and the Commissioner of Internal Revenue erred in failing to allow plaintiff's claims for refund.

VII.

Plaintiff in Civil No. 5758 is entitled to judgment in accordance with these findings of fact and conclusions of law in the sum of \$5,190.32 as a refund of income taxes for 1946, and in the sum of \$38,030.29 as a refund of income taxes for 1947, making a total of \$43,220.61 plus interest thereon, for which judgment shall be entered herein.

VIII.

Plaintiff in Civil No. 5759 is entitled to judgment

in accordance with these findings of fact and conclusions of law in the sum of \$7,000.00 as a refund of income taxes for 1946, and in the sum of \$30,865.50 as a refund of excess profits tax for 1944, making a total of \$37,865.50, plus interest thereon, for which judgment shall be entered herein. Any deficiency in income tax for 1944 attributable to the unused excess profits credit carry-back resulting in said excess profits tax refund of \$30,865.50 may be assessed in accordance with law (I.R.C. Sec. 276 (d) and other applicable provisions).

Judgment

Based upon the foregoing findings of fact and conclusions of law,

It Is Hereby Ordered, Adjudged and Decreed that plaintiff in Civil No. 5758 have and recover from defendant Hugh H. Earle, Collector of Internal Revenue for the District of Oregon, the sum of \$43,220.61 (said sum constituting a \$5,190.32 income tax refund for 1946 and a \$38,030.29 income tax refund for 1947), plus interest thereon at the rate of 6 per cent per annum from November 4, 1949, as provided by law.

The Court hereby certifies that there was probable cause for the acts done by defendant Hugh H. Earle, Collector of Internal Revenue for the District of Oregon, in regard to the collection and withholding of the taxes for which judgment is herein awarded.

It Is Further Ordered, Adjudged and Decreed that plaintiff in Civil No. 5759 have and recover

from defendant, United States of America, the sum of \$37,865.50 (said sum constituting a \$7,000.00 income tax refund for 1946 and a \$30,865.50 excess profits tax refund for 1944), plus interest thereon at the rate of 6 per cent per annum from November 4, 1949, as provided by law.

Dated this 12th day of June, 1951.

/s/ CLAUDE C. McCOLLOCH,
Judge.

State of Oregon,
County of Multnomah—ss.

Due service of the foregoing Findings of Fact, Conclusions of Law and Judgment, by copy, as prescribed by law, is hereby admitted, at Portland, Oregon, this 11th day of June, 1951.

/s/ DONALD W. McEWEN,
Of Attorneys for Defendant.

[Endorsed]: Filed June 12, 1951.

[Title of District Court and Cause.]

Civil No. 5758

NOTICE OF APPEAL

To W. J. Jones & Son, Inc., plaintiff, and William H. Kinsey of the firm of Wilbur, Oppenheimer, Mautz & Souther, attorneys for the plaintiff:

Notice is hereby given that Hugh H. Earle, Collector of Internal Revenue for the District of Ore-

gon, defendant above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the Judgment entered in this action on the 12th day of June, 1951, in favor of plaintiff and against defendant.

Dated this 8th day of August, 1951, at Portland, Oregon.

HENRY L. HESS,
United States Attorney for
the District of Oregon.

/s/ DONALD W. McEWEN,
Assistant United States
Attorney.

[Endorsed]: Filed Aug. 8, 1951.

[Title of District Court and Cause.]

Civil No. 5759

NOTICE OF APPEAL

To W. J. Jones & Son, Inc., plaintiff, and William H. Kinsey of the firm of Wilbur, Oppenheimer, Mautz & Souther, attorneys for the plaintiff:

Notice is hereby given that United States of America, defendant above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the Judgment entered in this action

on the 12th day of June, 1951, in favor of plaintiff and against defendant.

Dated this 8th day of August, 1951, at Portland, Oregon.

HENRY L. HESS,
United States Attorney for
the District of Oregon.

/s/ DONALD W. McEWEN,
Assistant United States
Attorney.

[Endorsed]: Filed Aug. 8, 1951.

[Title of District Court and Causes.]

Civil No. 5758

MOTION FOR EXTENSION OF TIME

Comes now the defendant above named, by and through his attorneys, Henry L. Hess, United States Attorney for the District of Oregon, and Donald W. McEwen, Assistant United States Attorney, and moves the Court for an order extending the time for filing the record on appeal and docketing the within action in the United States Court of Appeals for the Ninth Circuit to ninety days from the first date of filing of said Notice of Appeal. This motion is based on the grounds that the Department of Justice requires additional time to fully consider said appeal.

Dated at Portland, Oregon, this 11th day of September, 1951.

HENRY L. HESS,
United States Attorney for
the District of Oregon.

/s/ DONALD W. McEWEN,
Assistant United States
Attorney.

[Endorsed]: Filed Sept. 14, 1951.

[Identical Motion filed Sept. 14, 1951, in Civil
No. 5759.]

[Title of District Court and Cause.]

Civil No. 5758

ORDER

This matter coming on to be heard ex parte this day upon motion of defendant, through his attorneys, Henry L. Hess, United States Attorney for the District of Oregon, and Donald W. McEwen, Assistant United States Attorney, for an order extending time for the filing of the record on appeal and docketing the within action in the United States Court of Appeals for the Ninth Circuit, to enable the Department of Justice to have additional time to consider said appeal, and the Court being advised in the premises,

It Is Ordered that the time for filing the within

appeal and docketing the action be, and it is hereby extended to ninety days from the first date of the Notice of Appeal.

Made and entered at Portland, Oregon, this 14th day of September, 1951.

/s/ CLAUDE McCOLLOCH,
District Judge.

[Endorsed]: Filed Sept. 14, 1951.

[Identical Order entered and filed Sept. 14, 1951, in Civil No. 5759.]

[Title of District Court and Cause.]

Civil Nos. 5758 and 5759

DESIGNATION OF CONTENTS OF
RECORD ON APPEAL

To the Clerk of the Above-Entitled Court:

The defendant, Hugh H. Earle, hereby designates the entire record in this case to be contained in the record on appeal, more particularly described as follows:

1. Complaint and Summons.
2. Answer.
3. Pre-Trial Order.
4. Findings of Fact and Conclusions of Law.
5. Judgment.
6. Notice of Appeal.

7. Motion for Extension of Time.
8. Order.
9. All Exhibits.
10. Transcript of Testimony and All Proceedings at Trial.
11. This Designation.

Dated this 24th day of October, 1951.

HENRY L. HESS,
United States Attorney for
the District of Oregon.

/s/ DONALD W. McEWEN,
Assistant United States
Attorney.

[Endorsed]: Filed Oct. 24, 1951.

[Title of District Court and Cause.]

Civil No. 5758

STIPULATION

It is hereby stipulated by and between the parties herein through their counsel, Donald W. McEwen, Assistant United States Attorney, representing defendant Hugh H. Earle, and William H. Kinsey, of attorneys for plaintiff, that an order may be entered authorizing and directing the Clerk of the above-entitled Court to transmit to the United States Court of Appeals for the Ninth Circuit all

of the exhibits introduced at the trial of the above-entitled cause.

Dated this 31st day of October, 1951.

/s/ WILLIAM H. KINSEY,
Of Attorneys for Plaintiff.

/s/ DONALD W. McEWEN,
Of Attorneys for Defendant.

[Endorsed]: Filed Oct. 31, 1951.

[Identical Stipulation filed Oct. 31, 1951, in Civil No. 5759.]

[Title of District Court and Cause.]

Civil No. 5758

ORDER

This matter coming on to be heard upon motion of defendant, Hugh H. Earle, for an order authorizing and directing the Clerk of the above-entitled Court to transmit to the United States Court of Appeals for the Ninth Circuit all of the exhibits introduced at the trial of the above-entitled cause, and the Court having considered the stipulation of the parties on file herein authorizing said transmission of the exhibits and being advised, it is

Ordered that the Clerk of the above-entitled Court be, and he is hereby authorized and directed, to transmit to the United States Court of Appeals for

the Ninth Circuit all of the exhibits introduced at the trial of the above-entitled cause.

Made and entered this 31st day of October, 1951.

/s/ CLAUDE McCOLLOCH,
District Judge.

[Endorsed]: Filed Oct. 31, 1951.

[Identical Order filed Oct. 31, 1951, in Civil No. 5759.]

[Title of District Court and Cause.]

Civil Nos. 5758 and 5759

AFFIDAVIT

United States of America,
District of Oregon—ss.

I, Donald W. McEwen, being first duly sworn, depose and say that I am Assistant United States Attorney for the District of Oregon and one of the Attorneys of record for the defendant in the above-entitled action;

And that on the 26th day of October, 1951, I did serve on Attorneys for plaintiff a true and correct copy of the Designation of Contents of Record on Appeal in the above-entitled action by depositing in the United States Post Office at Portland, Oregon, on the 26th day of October, 1951, a duly certified copy thereof enclosed in an envelope, with postage

thereon prepaid, addressed to Wilbur, Beckett, Oppenheimer, Mautz & Souther, Attorneys at Law, Board of Trade Building, Portland, Oregon, Attorneys of record for plaintiff.

/s/ DONALD W. McEWEN,
Assistant United States
Attorney.

Subscribed and sworn to before me this 31st day of October, 1951.

[Seal] /s/ V. E. HARR,
Notary Public for Oregon.

My Commission expires 7/11/55.

[Endorsed]: Filed Oct. 31, 1951.

United States District Court
District of Oregon

Civil No. 5758

W. J. JONES & SON, INC.,

Plaintiff,

vs.

HUGH H. EARLE, Collector of Internal Revenue
for the District of Oregon,

Defendant.

Civil No. 5759

W. J. JONES & SON, INC.,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

Tuesday, May 15, 1951

Before: Honorable Claude McColloch,
Judge.

Appearances:

E. K. OPPENHEIMER, and

WILLIAM H. KINSEY,

WILBUR, OPPENHEIMER, MAUTZ &
SOUTHER,

Attorneys for Plaintiff.

A. F. OEHMANN,

Special Assistant to the United States Attorney, and

DONALD W. McEWEN,

Assistant United States Attorney

Attorneys for Defendant.

TRANSCRIPT OF TESTIMONY
AND PROCEEDINGS

Mr. McEwen: If your Honor please, in the case of Jones vs. United States and Jones vs. Earle, Civil No. 5759 and Civil No. 5758, I am pleased to present Mr. Oehmann. I would like to move his admission specially in this case.

The Court: That is satisfactory.

Mr. Oehmann: Thank you, your Honor.

(Opening statements made by counsel for the respective parties.)

CLAYTON R. JONES

was thereupon produced as a witness on behalf of Plaintiff, and, being first duly sworn, was examined and testified as follows:

Mr. Oppenheimer: If the Court please, and Counsel for the Government, there are probably some preliminary matters that we should attend to. I would like to offer certain exhibits. I assume it is satisfactory that can be done at the conclusion of the testimony.

The Court: In the usual tax case I have found this serves the purpose: I usually say that all ex-

(Testimony of Clayton R. Jones.)

hibits identified by the parties in their pre-trial conference and which have been marked will be deemed offered and admitted, subject to any objection stated in the pre-trial order or any objections that may be hereafter stated prior to the submission of the case. [2*]

Mr. Oppenheimer: I may want to refer to the exhibits as we proceed.

The Court: Yes.

(The following exhibits were thereupon offered and received in evidence:)

Plaintiff's Exhibits.	Description.
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- | | |
|--------|---|
| No. 1— | Plaintiff's Income Tax Return for the calendar year 1948. |
| No. 2— | Plaintiff's Income Tax Return for the calendar year 1946. |
| No. 3— | Plaintiff's Income Tax Return for the calendar year 1947. |
| No. 4— | Plaintiff's Income Tax Return for the calendar year 1944. |
| No. 5— | Plaintiff's Excess Profits Tax Return for the calendar year 1944. |
| No. 6— | Plaintiff's 1946 Refund Claim. |
| No. 7— | Plaintiff's 1947 Refund Claim. |
| No. 8— | Plaintiff's 1944 Refund Claim. |
| No. 9— | Revenue Agent's report on examination of plaintiff's 1946 refund claim and on examination of 1948 bad debt deduction. |

* Page numbering appearing at top of page of original Reporter's Transcript.

(Testimony of Clayton R. Jones.)

Plaintiff's Exhibits.	Description.
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No. 10—	Revenue Agent's report on examination of plaintiff's 1947 refund claim. [3]
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No. 11—	Revenue Agent's report on examination of plaintiff's 1944 refund claim.
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No. 12—	Revised statement on Revenue Agent's report covering examination of 1946 return of Clayton R. Jones.
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No. 13 to 44—	32 promissory notes of Mina del Refugio, S.A., payable to Clayton R. Jones, dated various dates from November 30, 1944, to December 30, 1946, aggregating \$121,763.74. (The individual notes have been separately numbered 13 to 44, inclusive.)
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No. 45—	Articles of Incorporation and Bylaws of Mina del Refugio, S.A., in Spanish, certified by the Consul of the United States at Nogales, Sonora, Mexico.
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No. 46—	Certified translation of the Articles of Incorporation and Bylaws identified in Exhibit 45.
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No. 47—	Original minute book of Mina del Refugio, S.A., in longhand and in Spanish.
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No. 48—	Translation of the minute book identified in Exhibit 47.
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No. 49—	Stock book of Mina del Refugio, S.A.
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No. 50—	Book of Mina del Refugio, S.A., containing record of cash received, check record and journal entries.
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(Testimony of Clayton R. Jones.)

Plaintiff's Exhibits.	Description.
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- | | |
|--|--|
| No. 51—General ledger of Mina del Refugio, S.A. | |
| No. 52—Letter dated June 30, 1944, from D. D. Kroder to Clayton R. Jones. [4] | |
| No. 53—Mining option agreement dated July 31, 1944, between Clayton R. Jones, John C. Higgins and Daniel Kroder. | |
| No. 54—Supplemental agreement dated August 31, 1944, between Kroder, Jones and Higgins, and related letter from Higgins to Kroder, dated August 31, 1944. | |
| No. 55—Trust agreement dated September 1, 1944, between Clayton R. Jones, John C. Higgins and D. E. Harris, with attached letter from Juan F. Robinson to D. E. Harris, dated August 10, 1944. | |
| No. 56—Translation of option and lease agreement dated October 31, 1944, from Jorge F. Robinson, Juan F. Robinson and Ana Robinson to Mina del Refugio, S.A. | |
| No. 57—Agreement dated November 20, 1944, between Clayton R. Jones, D. E. Harris and John C. Higgins. | |
| No. 58—Copy of the minutes of the meeting of the Board of Directors of Mina del Refugio, S.A., dated November 20, 1944. | |
| No. 59—Agreement dated March, 1945, between Clayton R. Jones, John C. Higgins and D. E. Harris. | |

(Testimony of Clayton R. Jones.)

Plaintiff's Exhibits.	Description.
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No. 60—Letter dated April 17, 1945, from
Walter M. Wells to Clayton Jones.

No. 61—Letter dated July 29, 1945, from A. J.
Klamt to Higgins and Jones. [5]

No. 62—Letter dated March 21, 1946, from
John C. Higgins to Malcolm C. Little.

No. 63—Letter dated March 25, 1946, from
John C. Higgins to Arthur E. Johnson.

No. 64—Letter dated May 16, 1946, from Clay-
ton R. Jones to Walter Wells.

No. 65—Journal entry sheet of plaintiff for Au-
gust 31, 1946.

No. 66—Journal entry sheet of plaintiff for De-
cember 31, 1946.

No. 67—Account sheet of Clayton R. Jones with
plaintiff for 1946.

No. 68—Letter dated April 4, 1947, from Clay-
ton R. Jones to Walter M. Wells.

No. 69—Letter dated August 4, 1947, from John
C. Higgins to Juan F. Robinson.

No. 70—Letter dated January 15, 1948, from
A. J. Klamt to John C. Higgins.

No. 71—Letter dated March 9, 1948, from Clay-
ton R. Jones to Walter M. Wells.

No. 72—Letter dated April 1, 1948, from A. J.
Klamt to Mina del Refugio, Portland,
Oregon.

No. 73—Letter dated April 8, 1948, from Clay-
ton R. Jones to A. J. Klamt.

(Testimony of Clayton R. Jones.)

Plaintiff's Exhibits.	Description.
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No. 74—Telegram dated November 15, 1948,
from Clayton R. Jones to A. J. [6]
Klamt.

No. 75—Two letters dated December 27, 1948,
from John C. Higgins to A. J. Klamt.

No. 76—Copy of minutes of meeting of the
Board of Directors of Mina del Re-
fugio, S.A., held on December 27, 1948.

No. 77—Statement dated December 27, 1948,
signed by A. J. Klamt.

No. 78—Journal entry sheets of plaintiff for
December 31, 1948.

No. 79—Various journal entry sheets and ac-
count sheets of plaintiff showing ac-
cruel of interest on Mina del Refugio,
S.A., notes.

Direct Examination

By Mr. Oppenheimer:

Q. Will you state your name, please?

A. Clayton R. Jones.

Q. What position do you occupy in the W. J.
Jones & Son corporation? A. President.

Q. State the ownership of the stock which you
had in W. J. Jones & Son, Inc., during the years
1946, 1947 and 1948.

A. It ranged—I personally owned in those years
between 47 and [7] 49 per cent.

(Testimony of Clayton R. Jones.)

Q. When did you first have called to your attention the mining property, which will be known in this record as the Mina del Refugio? In what manner was that property called to your attention?

The Court: In your opening statement you began it that "This was the lost Mexican mine."

Mr. Oppenheimer: As your Honor will see as things develop.

The Court: You know that famous old scheme, I guess. That letter has been coming into the United States for a hundred years.

Mr. Oppenheimer: Oh, yes, something like some of these schemes where a fellow still owns Long Island.

The Court: Was it a mining property?

Mr. Oppenheimer: Yes.

The Court: What state?

Mr. Oppenheimer: Sonora, Mexico.

The Witness: A hundred miles east of Hermosillo.

Q. (By Mr. Oppenheimer): Where with relation to Mexico City?

A. 200 miles south of Nogales, Arizona, 200 miles south of the border.

Q. I now call your attention to Exhibit 52, which is a letter from D. D. Kroder, addressed to you, under date of June 30, 1944, and will ask you to briefly tell the Court whether that is a communication you received and the circumstances. [8]

A. This is the first direct communication I had from Mr. Kroder who, in turn, had been in touch

(Testimony of Clayton R. Jones.)

with Mr. Wells in New York, who had first notified me about the mining property.

The Court: I will look at the exhibits as they come in, as you refer to them.

Mr. Oppenheimer: Yes, your Honor. Do you want them read at this time?

The Court: No, I will read them.

Q. (By Mr. Oppenheimer): After you received Exhibit 52 what, if anything, did you do?

A. I contacted a friend of mine, Mr. Harris, whom I had been in previous mining ventures with, and who was then in California, and told him about it and asked him whether he would like to go down there and look the property over. He did, and his preliminary observations were favorable.

I had never had any experience in underground mining, and I contacted Mr. John C. Higgins of Portland, who had had experience in underground mining, and asked him whether he would be interested in the proposition, and he replied in the affirmative; and we decided to send down a geologist and mining manager by the name of Mr. Klamt, and an engineer and mining manager by the name of Mr. Gibson, to make a further report on the property.

Q. After that did the negotiations culminate in the execution of an option? A. They did. [9]

Q. I now call your attention to Exhibit 53 and ask you whether or not that is the mining option that you say was the culmination of this investigation, the same bearing date the 31st day of July,

(Testimony of Clayton R. Jones.)

1944, and signed by Daniel D. Kroder, first party, and by John C. Higgins and Clayton R. Jones as second parties?

A. This is the option which was executed by Mr. Higgins and myself and Mr. Kroder.

Q. I particularly call your attention to two or three paragraphs of that option of 1944. Paragraph 4 reads as follows:

“Parties hereto contemplate the organization of a Mexican corporation to be named as grantee in the deed conveying said mining property and the \$35,000 provided by second parties hereto shall be in the form of a loan to said corporation represented by notes of the corporation and repayable within two years from their date, with interest at five per cent. Said notes shall be payable either at or before their maturity before any dividends shall be declared by said corporation.

“5. The stock of the aforesaid corporation shall be distributed one-third to first party and two-thirds to second parties.

“6. First party agrees to devote all of his time to the management of the affairs of said corporation during a development period of four months and he shall [10] receive therefor a salary of three hundred dollars (\$300) per month.”

Was that \$35,000 advanced as called for by the option?

A. It was.

(Testimony of Clayton R. Jones.)

Q. In that option, which is Exhibit 53, it is recited in one of the paragraphs that one-third was to go to Kroder. Will you please state the circumstances under which Kroder was to acquire one-third in the venture?

A. He was to acquire it due to the fact that he had been the finder in bringing it to Mr. Wells, who in turn had brought it to me, plus the fact that he was to devote his full time at a specified salary for a certain length of time in the exploration and exploitation of the property.

Q. Was any payment made by Mr. Kroder for that one-third interest?

A. No. Well, there was—that was subsequently changed.

Q. I will come to that, but was any payment made for any interest by Kroder in the venture?

A. Not at that time, to my recollection.

Q. Did he, at any subsequent time, put any money in the venture?

A. I don't understand. I guess I didn't understand that question. I thought you said did we pay Kroder?

Q. No. We will come to that later on.

A. Will you restate that question? I don't understand it.

(Question read.) [11]

A. No.

Q. (By Mr. Oppenheimer): Was that one-

(Testimony of Clayton R. Jones.)

third interest subsequently changed to another proportion? A. It was.

Q. I now call your attention to Exhibit 54, which is a letter from Mr. Daniel D. Kroder to Mr. Higgins and yourself under date of August 9, 1944, to which is attached a copy of the mining option and supplemental agreement. I will ask you to state the circumstances under which that document was executed.

A. This letter and document pertain to a change of agreement wherein the Kroder interests were to receive twenty per cent instead of the original thirty-three and one-third per cent, due to the fact that Kroder did not want to be tied down at this mine and Kroder's twenty per cent was divided between himself, ten per cent, and Mr. A. E. Johnson, ten per cent.

Q. How did Mr. Johnson come into the picture, if you know?

A. He was a finder with Mr. Kroder, and there had been a previous agreement between the two of them that they would share and share alike.

Q. Was the property finally acquired under a trust agreement? A. It was.

Q. I now call your attention to Exhibit 55, which is the agreement of trusteeship between Clayton R. Jones and John C. Higgins, as First Parties, and D. E. Harris, as Second Party, and ask if this is the trust agreement under which the property was acquired? [12]

(Testimony of Clayton R. Jones.)

A. Yes, sir. This is the trust agreement under which the property was acquired.

Q. State whether or not a going Mexican corporation was acquired by Mr. Higgins, Mr. Harris and yourself?

Mr. Oehmann: I object to the characterization of a "going Mexican corporation." There is no evidence whatever that it was a going concern.

Mr. Oppenheimer: I will delete the word "going," and change it to "a corporation in existence." Is that satisfactory?

Mr. Oehmann: Surely.

Q. (By Mr. Oppenheimer): Did you acquire an existing Mexican corporation?

A. We did.

Q. What was the name of the corporation?

A. Mina del Refugio.

Q. Did you have anything to do with the organization of that corporation? A. No.

Q. Did any of your associates? A. No.

Q. What became of the mining rights acquired under that trust agreement that has been referred to as Exhibit 55?

A. They were assigned to the corporation referred to.

Q. I now call your attention to Exhibit 56 and ask you if that is the document by which the mining rights were transferred from [13] the trusteeship to the Mexican corporation? A. Yes, it is.

Q. I will ask you if, subsequent to the assignment, or thereabouts, an agreement was entered into

(Testimony of Clayton R. Jones.)

between Clayton R. Jones, D. E. Harris and John C. Higgins as first parties, and Mina del Refugio as the company? A. Yes.

Q. I now call your attention to Exhibit 57 and ask you if that is the agreement?

A. Yes, it is.

Q. Of course, the agreement speaks for itself, but does it cover what should be done in connection with the advances of money? A. Yes.

Mr. Oppenheimer: With your Honor's permission, may I read certain paragraphs of Exhibit 57?

I am now reading subparagraph (c) of Clause First—this agreement bears date the 20th day of November, 1944.

“(c) Upon demand of the parties entitled thereto, the Company shall execute and deliver to each of the First Parties its note or notes, payable two years from date, for the agreed purchase price and reasonable value of all used equipment heretofore or hereafter sold and delivered to the Company; the principal sum of said note or notes shall bear interest at six per cent per annum [14] from the date or dates when the equipment represented thereby shall have been delivered for use at the Robinson mining properties, said interest being payable at maturity.

“(d) All moneys advanced or expended by First Parties for any of the purposes described in Clauses (a) and (b) above, together with

(Testimony of Clayton R. Jones.)

the amounts representing the reasonable purchase price and value to the Company of the mining and milling equipment sold and delivered to the Company as stated in Clause (c) above, together with interest thereon in accordance with the terms above stated, shall become obligations of the Company from the dates when such moneys were advanced or expended and from the dates of delivery to the Company of the aforesaid equipment, and the Company shall be and remain indebted under open account for the aforesaid amounts and interest thereon as aforesaid to the respective persons who advanced or expended the moneys or who sold and delivered the equipment, until such persons shall have been reimbursed by the Company therefor or until the Company shall have executed and delivered to such persons its note or notes therefor as above provided.

“(e) Upon demand therefor by the party entitled thereto, the Company shall execute and deliver to each of [15] the First Parties chattel mortgages on all items of equipment sold and delivered to the Company by such party, giving to such party a lien on such items of equipment to secure the payment of the purchase price therefor and the interest thereon as above provided.”

Q. Was the agreement, which is represented by Exhibit 57, ever ratified by the corporation known as Mina del Refugio? A. It was.

(Testimony of Clayton R. Jones.)

Q. I hand you now Exhibit 58 and will ask you if those are the minutes of the corporation ratifying the agreement, Exhibit 57?

A. Yes. This is the ratification, the minutes of the meeting.

Q. What was the date of that meeting?

A. The 20th day of November, 1944.

Q. Did you advance various sums of money personally, from time to time, to Mina del Refugio?

A. I did.

Q. Were those advances represented by promissory notes? A. They were.

Q. I now call your attention to Exhibits 13 to 44, inclusive, which are promissory notes which have a face total of \$121,763.74, and ask you if you ever saw them before and under what circumstances?

A. I have seen these before. They were handed me by the President of Mina del Refugio corporation, Mr. John C. Higgins, in return for cash advances that I had made to the corporation. [16]

Q. State whether or not you advanced any sums in excess of the amounts represented by Exhibits 13 to 44? A. I did.

Q. What was the amount of the total advances, without including interest?

A. The total advances above that were about \$30,000.

Q. So that would mean total advances of approximately \$150,000?

A. Yes. It was a little in excess of that.

(Testimony of Clayton R. Jones.)

Q. State whether or not these notes, principal or interest, in whole or in part, have ever been paid.

A. They have not.

Q. Have you received anything towards the payment of these notes from the liquidation of the mine?

A. Yes. There was a sum distributed, approximately \$9,000—that was the share received by W. J. Jones & Son.

Q. That is the corporation? A. Yes.

Q. After you acquired these notes which are in evidence as Exhibits 13 to 44, what, if anything, did you subsequently do with these notes?

A. I sold these notes to the corporation at their face value, without recourse. Some of them were sold in August, the end of August, 1946, and some of them were sold in the end of December, 1946.

Q. Do you remember how many of the notes were sold on August 31, [17] 1946?

A. I don't have those figures in my mind.

Q. All were eventually sold, together with the interest? A. All \$120,000 worth, yes.

Q. When we talk about \$121,000, that is the face amount, but the interest went with them?

A. Yes.

Q. What did you receive for the sale of those notes?

A. A credit on the books of W. J. Jones & Son for cash advances that that company had made to me.

Q. Prior to the time you received this credit,

(Testimony of Clayton R. Jones.)

were you a creditor or debtor of W. J. Jones & Son?

A. I was a creditor of W. J. Jones & Son.

Q. Before you sold the notes, how did your account stand?

A. I owed them about \$100,000.

Q. So you were a debtor rather than a creditor?

A. Well, I owed them—yes, I was a debtor.

(Recess.)

Q. (By Mr. Oppenheimer): You spoke about a figure of \$9,000 being salvage recovery. During the recess did you check to ascertain the accurate figures and, if so, will you tell the Court what they are?

A. All right. W. J. Jones & Son recovered \$8,694.42 as a result of the salvage of the equipment; that is, their proportion. [18]

There had been an estimated recovery set up on the books in 1948 of \$8,775, and there was a deficiency in the recovery of \$80.58.

Q. After W. J. Jones & Son, Inc., acquired the notes in question, which are Exhibits 13 to 44, inclusive, state whether or not they were set up on the regular books of the corporation?

A. They were.

Q. I now call your attention to Exhibits 65 and 66, which I believe are admitted to be the original records of W. J. Jones & Son, and ask you to call the Court's attention to the manner in which they were set up on the books. Take Exhibit 65, first.

(Testimony of Clayton R. Jones.)

A. Under date of August 31, 1946, there is a general entry as follows: Notes receivable, Mina del Refugio, \$102,930.96; accrued interest, \$4,654.57, making a total of \$107,585.53.

There is a second entry dated December 31, 1946, in the journal which shows: Notes receivable, Mina del Refugio, \$18,832.78. Both of those entries are a credit to myself. The first one is a credit of \$107,585.53, and the second one is a credit of \$18,832.78.

Q. I think you have previously testified that prior to the credits you have just outlined in your testimony you were owing to the corporation, in round figures, about \$100,000. A. I did.

Q. Did you subsequently draw on this credit that was over \$100,000. [19]

A. I don't understand that question.

Q. You had a credit on the books of W. J. Jones & Son, Inc., in excess of the indebtedness, by virtue of the corporation buying these promissory notes. In other words, the corporation then owed you money?

A. No, they did not. I still owed the corporation about three or four thousand dollars.

Q. You did?

A. According to my recollection.

Q. On what basis did W. J. Jones & Son, Inc., operate?

A. They kept their books on an accrual basis.

Q. How were these notes carried on their books?

A. The interest was accrued each month and

(Testimony of Clayton R. Jones.)

credited to the interest account, as a profit or gain, and at the end of each year there was income tax paid to the government on that interest so accrued from the notes that the corporation purchased from me.

Q. I now call your attention to Exhibit 79, the income ledger, and ask you if these are records of W. J. Jones & Son, Inc., showing the accrual of interest on the notes in question? A. They are.

Q. I will ask you to state if eventually this indebtedness owing to the corporation by the Mina del Refugio was charged off on the books of W. J. Jones & Son, Inc.? A. It was. [20]

Q. I now call your attention to Exhibit 78 and ask that you point out the charge-off?

A. I am reading from the journal entry under date of December 31, 1948. There is a charge to Bad Debts of \$143,330.21, and the offsetting entries are as follows: Notes Receivable, \$121,763.74; interest receivable, \$21,566.47, and the explanation following that entry reads as follows:

“Charging off bad debt account Mina del Refugio, notes receivable and accrued interest to December 31, 1948.”

Then I find another entry under the same date, which debits Mina del Refugio \$8,775, and a credit to profit and loss of \$8,775, and an explanation under this entry as follows:

(Testimony of Clayton R. Jones.)

“To set up estimated amount of recovery on notes of Mina del Refugio assigned to this corporation by Clayton R. Jones, 39 per cent of \$22,500.”

Q. Do you know a man by the name of Walter M. Wells? A. I do.

Q. Without too much elaboration, tell us briefly who Walter M. Wells was.

A. He is president of the Isthmian Steamship Corporation of New York City, a personal friend of mine for over twenty years and the man who originally wrote me about this Mina del Refugio property, in which I subsequently became interested.

Q. Did he ever acquire any interest in this Mina del Refugio? [21] A. He did.

Q. What? A. He did.

Q. I call your attention to Exhibit 60, which is a letter from Walter M. Wells, under date of April 17, 1945. Tell the Court what interest he acquired and what was paid for it?

A. He acquired nine per cent of the mine, of the capital stock of the mine, from Mr. Kroder, for the sum of \$5,000 and also a small sum which was advanced before that period.

Q. Did Mr. Higgins and yourself acquire any interest of either of these finders? A. Yes.

Q. I call your attention to Exhibit 63, which is a letter from John C. Higgins to Arthur E. Johnson, under date of March 25, 1946, and ask you to tell the Court when you acquired Johnson's interest and under what circumstances?

(Testimony of Clayton R. Jones.)

A. On March 25, 1946, Mr. Higgins wrote a letter to Mr. Johnson, the co-finder with Mr. Kroder wherein Mr. Higgins, in behalf of himself and myself, paid Johnson \$4,000 for the purchase of nine per cent of his stock.

This was brought about by the fact that Mr. Johnson developed cancer, and was told he had a very short time to live and he wanted to clean up his affairs before his demise.

Q. Without detailed elaboration, what were the prospects of this mining venture known as Mina del Refugio? [22]

A. At what time?

Q. From the beginning.

A. Well, from the beginning we thought that we had a money-making mining venture. We anticipated that we would not have to expend in excess of \$50,000 when we started this venture. We figured that Mr. Higgins and I would advance the moneys jointly. Mr. Harris had come in for \$3,000 and that meant that Higgins and I would, roughly, advance \$23,500 each.

The plan of operation was this: We had reason to believe that we had high-grade ore that we could ship to the smelter and get our exploration and exploitation money back from this high-grade ore without any large capital sum being invested.

We did ship two or three cars of ore. We made a profit on the ore we shipped, but the shipping charges were so high and the values of our ore went down in value. We discontinued shipping ore and

(Testimony of Clayton R. Jones.)

we blocked out an amount of ore which our engineer estimated would amount to \$409,000.

Q. Let me interrupt you there. I now hand you Exhibit 61 and ask you what this report demonstrates? I appreciate it speaks for itself, but this is in connection with your present testimony.

A. Under date of July 29, 1945, there was a letter addressed to Messrs. Higgins and Jones. Without going into detail, it states that the mine development was in a most favorable position. The words "gratifying results" are used here, with details as [23] to what was found on each level and on certain raises.

Q. How much in dollars and cents does that report show as ore being blocked out?

A. This statement shows that there was 8,352 tons of ore blocked out at an estimated value of \$409,163.

Q. Was there any ore that was not blocked out?

A. Yes. At that time we thought we had reason to believe that these veins would run a long ways on the levels on which we were working, and on the downward development we had no reason to believe that they would pinch out there either. At this time the prospects of this mine were very rosy.

Q. I call your attention to Exhibit 68, which is a letter you wrote to Walter M. Wells, under date of April 4, 1947, you having mentioned Mr. Wells in your previous testimony, and I will ask you to tell the Court what the first gold bricks that were developed showed and whether they were of value?

(Testimony of Clayton R. Jones.)

A. Under date of April 4, 1947, after we had erected a mill at a very substantial investment, the first six bricks which were melted down amounted to about \$7,000 in American money.

Q. What were the prospects?

A. The prospects were very rosy. As stated in this letter, the mill was getting shaken down, and we hoped to do better.

Q. I will ask you to state whether you ever had an inquiry as to whether or not you and your associates were willing to sell your interest in this mine? [24] A. I did.

Q. I call your attention to Exhibit 64 and ask you to outline to the Court the suggestion of sale.

A. The letter you have handed me is a letter I wrote on May 16, 1946, in response to a request I had from Mr. Wells in New York, asking us to place a valuation on the mine, on our interest in the mine, namely, Mr. Higgins and myself.

After discussion with Mr. Higgins, we offered to sell our respective shares in the mine for \$500,000.

Q. What date was that? A. May 16, 1946.

Q. I call your attention to Exhibit 69 and ask you to advise the Court when you and your associates paid the last \$10,000 on the original option price for the mine in question?

A. This was paid on August 4, 1947. There was a letter dispatched concerning a telegram that we were ready to make final payment on the properties in the sum of \$10,000.

Q. What date was that, please?

(Testimony of Clayton R. Jones.)

A. August 4, 1947.

Q. I now call your attention to Exhibit 70, which is a letter from the engineer, A. J. Klamt, addressed to John C. Higgins, under date of January 15, 1948, and ask you to tell the Court when you first had any intimation that things were not going according to schedule and according to your understanding that the project was on a successful basis. [25]

A. On January 15, 1948, there was a letter written from Hermosillo, Sonora, to John C. Higgins, stating that the ore shoot was much shorter than he had expected on the 260-foot level, and that the ore was changing—the vein was changing from ore to gouge, and this was the first intimation that I had that we were not developing new ore and that there might be something wrong.

Q. What did you do after receipt of that letter or when that letter came to your attention?

A. I conferred with Mr. Higgins, and it was decided I would go down there and make a personal examination.

Q. Did you go to Mexico? A. I did.

Q. What did you find, if anything?

A. I found that the blocked-out ore previously referred to in Blocks A, B and C had been exhausted, that the recovery was nowhere near what our engineer had prognosticated; and that the remaining ore in the other two blocks, namely "E" and "F," was very far short of the tonnage that we anticipated.

Q. Upon your return did you make a report,

(Testimony of Clayton R. Jones.)

outside of a personal report to Mr. Higgins or anyone else, to Mr. Walter M. Wells, in New York?

A. I did.

Q. I call your attention to Exhibit 71 and ask you if that is a letter you wrote? [26]

A. On my return I wrote a letter to Mr. Wells, under date of March 9, 1948, and explained in that letter that during the previous year we had experienced a \$20,000 loss and our recoveries fell down 60 per cent, and stated that in my belief at that time we could run about a year and that unless they turned up with some new ore bodies this project was going to be a colossal failure.

Q. I call your attention to Exhibit 72, which is a letter written to Mina del Refugio by A. J. Klamt, and ask you whether the inability to find a new vein of new ore continued?

A. This is a letter dated April 1, 1948, going into detail as to exploration work, and the summation of it is that there was no new ore being developed.

Q. I now hand you Exhibit 73 and ask you if you will tell the Court whether you responded to Mr. Klamt's letter, which is Exhibit 72?

A. On April 8, 1948, I replied to the letter previously referred to, in the foregoing exhibit, and confirmed we had found no new ore and that he was not getting any results in the pumping operation on another mine on this same property, namely, the Noche Bueno mine.

Q. Was it in November, 1948, that you finally

(Testimony of Clayton R. Jones.)

decided to dismantle the mine? A. Yes.

Q. In connection with that I call your attention to Exhibit 74. [27]

A. On November 15, 1948, there was a telegram dispatched under my signature to Mr. Klamt, reading as follows:

“Higgins and I request you commence dismantling mill immediately transporting all supplies and materials to our corral in Hermosillo. **Your instructions** are to list each truckload in detail leaving mine and have Smith check in detail and receipt, advising Portland office of quantities shipped each week. We desire you salvage all possible materials, especially lumber, for resale at Hermosillo. We suggest you bring pipe in first and advertise quantity and sizes in Hermosillo paper. You will telegraph offers to Portland for confirmation.”

Q. Did Mr. Higgins enter into the so-called dismantling agreement and, if so, I will call your attention to Exhibit 75, which bears date December 27, 1948, with accompanying attached letter signed by Mr. Higgins.

A. On December 28, 1948, there was an agreement entered into with Mr. Klamt for salvaging the equipment on a lump-sum basis, which was payable to the Mina del Refugio corporation. Anything over that amount that he received was to be his compensation for selling the property, and it relieved the corporation of any further salary expense and rental of the corral, and, in the judgment of

(Testimony of Clayton R. Jones.)

the directors, that was deemed the most expeditious way to dispose of the property. [28]

Q. I call your attention to Exhibit 76, minutes of a special meeting of the board of directors of Mina del Refugio, in connection with this dismantling, which speaks for itself. First, I will ask you if those are the minutes?

A. Yes, these are the minutes of a meeting that we held in Mr. Higgins' office on December 27, 1948.

Q. Did you ever receive any report from Mr. Klamt, the engineer, certifying that there was no further ore? A. We did.

Q. I call your attention to Exhibit 77 and ask you to state whether or not that is the certification?

Mr. Oehmann: I object to that exhibit, your Honor, on the ground, first, that it is an opinion of Mr. Klamt that what these men did was justified. I don't know whether it is intended to be the statement of an expert, but it does not appear to me to be competent at all in this case.

Mr. Oppenheimer: It is a sort of an opinion. I will not press the matter, however. It has been covered here in this certificate.

The Court: If you want to put it in, it is admitted subject to the objection.

Mr. Oppenheimer: In line with your Honor's ruling that all pre-trial exhibits are introduced subject to objection, I will assume that they are in and that if there are any specific objections the Government will make them. [29]

The Court: Yes.

(Testimony of Clayton R. Jones.)

Mr. Oppenheimer: You may cross-examine.

Cross-Examination

By Mr. Oehmann:

Q. Mr. Jones, I believe you testified that you owned at the most forty-nine per cent of the stock of W. J. Jones & Son, Inc., in the years referred to. Is it not a fact that you owned about fifty-nine per cent in December, 1946?

A. I could not answer that question without reference to the books. I believe there is a statement in court by the secretary of our corporation that I owned forty-seven and forty-nine per cent in 1946. I might be in error, but it is not intentional.

Mr. Oppenheimer: I have a tabulation if the Government wants it. It is not in evidence.

Q. (By Mr. Oehmann): The balance of the outstanding stock was owned by members of your family, was it not, Mr. Jones? A. Yes.

Q. All of it? A. Yes.

Q. During the years involved—that is, between 1944 and 1946, you advanced approximately \$150,000 to the mine? A. Yes, sir.

Q. Mr. Higgins advanced the same amount, approximately, did he not? [30] A. Yes, sir.

Q. In August, 1946, you had an outstanding balance that you owed W. J. Jones & Son, Inc., of about \$100,000, did you not?

A. Approximately.

(Testimony of Clayton R. Jones.)

Q. Did the money that you advanced to the Mina del Refugio come from this corporation?

A. Yes, and charged to my account.

Q. Charged to your account? A. Yes.

Q. It was principally those withdrawals from your company that built up the balance which you offset in 1946 with the mining company note?

A. That is correct, plus personal money.

Q. Yes, but the larger part went right into the mining properties? A. That is right.

Q. You recall at the outset approximately \$1,000—that is, 5,000 pesos—were paid in for the stock of the mining company? A. That is correct.

Q. It was about \$1,000, wasn't it?

A. Yes.

Q. What equipment did the mine have at the time you and Mr. Higgins took it over; that is, when you first signed up the agreement; I do not mean when you finally paid the \$35,000 but when you first took over? [31]

A. There was some very crude equipment turned over with the leases of very nominal value or practically none.

Q. Practically none? A. Yes.

Q. So, the \$1,000 paid in for the stock was the whole capital invested at the beginning, wasn't it?

A. No, sir.

Q. What else was invested?

A. There was a mining value in the prospects of that mine that in my opinion had a minimum value of \$50,000 and could run up into hundreds of

(Testimony of Clayton R. Jones.)

thousands, due to the fact that those veins showed such excellent progress at that time and——

Q. I am just talking about the time——

Mr. Oppenheimer: Let him finish.

Mr. Oehmann: The answer is not responsive. I am talking about the time when you first started operations, not after you determined by exploration what was there, but at the time you started.

Mr. Oppenheimer: Just a minute. If the Court please, the Government has asked a question and because the answer is not to counsel's liking that isn't any reason for shutting him off.

The Court: This is a very fine gentleman——

Mr. Oppenheimer: I know he is.

The Court: I know what he is speaking about. I am an old mining man. I come from Baker. [32]

Mr. Oehmann: I think your Honor knows.

The Court: I know what you are after.

Mr. Oehmann: A lot of the evidence that went in on direct was objectionable in the manner in which it was brought out or presented, but I made no objection.

The Court: Go ahead and develop it. You answer in your own way.

Q. (By Mr. Oehmann): You have testified you had great expectations of a substantial return on this \$1,000 investment. Isn't that what you testified to?

A. No, sir.

Q. Is that what you mean?

A. I didn't testify to that at all.

(Testimony of Clayton R. Jones.)

Q. What was your investment, then, aside from the \$1,000 that was paid in for the stock?

A. We had the investment of two engineers that we sent down there to get technical reports that, to the best of our knowledge, were reasonable reports on what that property should—on what that property showed, rather, and the samples that they took at the time led us to believe or led me to believe that this property had a minimum of \$50,000 value and it could run into the hundreds of thousands.

Q. But you only invested what you paid for the stock, plus the expenses of the engineers and plus your expenses down there. That is all you invested, isn't it? [33]

Mr. Higgins: I know some of these facts. I think Counsel is mistaken.

Mr. Oehmann: I object to that statement. I have no objection to Mr. Higgins being here, but I object to his making comments.

Mr. Higgins: I will make my comments in Counsel's ear, if I may.

The Court: We will put you on record as counsel, if you want to be.

Q. (By Mr. Oehmann): Isn't it a fact, Mr. Jones, that you paid an engineer to go down there and look at the property and report to you?

A. That is correct.

Q. Your expenses in connection with the investigation and report were about \$13,000, up to the time you signed the first option agreement?

A. Yes.

(Testimony of Clayton R. Jones.)

Q. So, then, it could be stated you had an investment of \$13,000 plus what you paid for the stock?

A. No. That is what I tried to tell you. You won't let me state my facts. The corporate structure did not come into existence until subsequent to the employment of Klamt and the estimates and samples that we had taken there.

Q. But that had been in existence for some time prior thereto. You just took over an existing corporation? [34]

A. Yes, that is right.

Q. Then it did not come into existence after you made your investigation and purchased the stock?

A. I meant the corporate structure came into the hands of the stockholders, referred to in this proceeding.

Q. You acquired your interest in it at the time you decided to take over and operate the mine?

A. That is right.

Q. You considered your investment represented what you expected to get out of the property in the way of a return from ore to be extracted? Is it your position that is what your investment was?

A. Will you read the question?

(Question read.)

The Court: We will recess at this time until 2:00 o'clock.

(Thereupon, at 11:45 a.m., a recess was taken until 2:00 o'clock p.m.) [35]

(Testimony of Clayton R. Jones.)

Court reconvened at 2:00 o'clock p.m., Tuesday, May 15, 1951, pursuant to recess.

Cross-Examination
(Continued)

By Mr. Oehmann:

Q. Mr. Jones, during the noon recess did you refresh your recollection from this schedule of your stock ownership in W. J. Jones & Son, Inc., the schedule which Mr. Oppenheimer had here?

A. Yes.

Q. Was your interest fifty-nine per cent in 1945?

A. Yes, I believe that is shown there. Is it?

Q. Yes. A. That is correct.

Q. Forty-eight per cent in 1946? A. Yes.

Q. Forty-seven per cent in 1947? A. Yes.

Q. And forty-seven per cent in 1948?

A. Yes.

Q. I direct your attention to Exhibit 59.

Mr. Oppenheimer: Pardon me. In reading this did I understand you to say his ownership was fifty-nine per cent in 1946?

Mr. Oehmann: 1945.

Mr. Oppenheimer: Thank you.

Q. (By Mr. Oehmann): Exhibit 59, the agreement between you and [36] Mr. Higgins and Mr. Harris, executed in March, 1945—you recall there was such an agreement? A. Yes.

Q. I direct your attention to Paragraph 4 which reads:

(Testimony of Clayton R. Jones.)

“It has been agreed by and between the parties hereto that ten per cent of the stock of the aforesaid corporation shall be issued to Arthur E. Johnson, or his assigns, ten per cent to Daniel D. Kroder, or his assigns, and the remaining eighty per cent of the stock of said corporation shall be divided between Clayton R. Jones, John C. Higgins and the above-named members of the Harris family, in proportion to their respective contributions in cash and in equipment, at its reasonable value, and that such stock shall be so distributed when the total of said contributions, as finally made, has been determined.”

It was your intention, was it not, at the time this agreement was executed, that your stock ownership should be in the same relation as your contributions of cash, equipment and advances and so forth?

A. That is correct, yes.

Q. Did you have any experience at all in this type of business, in mining?

A. I had had experience in the mining business, in gold dredging but not in underground mining. This was my first venture in [37] underground mining, but I had been in the mining business.

Q. You relied, did you not, on Mr. Klamt, as engineer or manager there?

A. To a certain extent, yes, and together with consultation with my other associates.

Q. There came a time, did there not, when you

(Testimony of Clayton R. Jones.)

didn't think much of his judgment, isn't that true? In your letter, Exhibit 71, your letter to Mr. Wells of March 9, 1948, after reciting—this is the letter in which you said the company “is a very sorry picture?”

A. That is correct.

Q. Do you recall that letter? A. Yes.

Q. Do you also recall saying, “This long-distance management is a very difficult situation and, although I do not believe Mr. Klamt wilfully led us astray, his judgment was very, very bad.”

A. That is right.

Q. You did not think much of his judgment, then, in March of 1948? A. No, sir.

Q. Would you give much weight to his judgment in December, 1948, with respect to the same kind of a problem?

A. I don't know what you are referring to as the same kind of a problem. The problem in 1948 has no resemblance to the problem referred to in that letter. [38]

Q. The problem in March, 1948, was to operate this mine profitably, wasn't it?

A. That was part of it, but it was mainly to discover additional ore.

Q. Which would have made it a profitable operation, wouldn't it? A. Yes, that is right.

Q. The problem at the end of 1948 was whether this mine was too unprofitable to justify the continuance of the operation, wasn't it?

A. No, that wasn't it.

Q. That is all it was, wasn't it? A. No.

(Testimony of Clayton R. Jones.)

Q. Why did you abandon it then?

A. Because we had used up all the ore that was found and there was no more new ore in sight.

Q. What percentage of the stock of the mine did you hold?

A. I think the records will show approximately thirty-nine per cent. That is from memory. I think the records are here.

Q. Did members of your family hold about ten per cent? A. No, I held the stock.

Q. How much did Mr. Higgins hold?

A. Approximately the same. We were on a fifty-fifty basis.

Q. That was throughout the whole term of this operation? A. Yes. [39]

Mr. Oppenheimer: If you want the figures here, I think we can give them.

Mr. Oehmann: I don't want any now, sir. Thank you.

Q. Tell me, will you, Mr. Jones, what is meant by "blocked out"? What is meant when you say you had four hundred and some thousand dollars in ore blocked out? A. Yes.

Q. What does that mean?

A. Well, in the first place there is a shaft put down and then there are winzes run each way and into various segments. These segments are marked out where the ore is found at different levels.

In this particular mine we had ore on the 90-foot level; we had it down on the 130 and down on the 200-foot level.

(Testimony of Clayton R. Jones.)

If you had a blackboard here, I could explain it to you, but there are segments in there and each—there are tests run at stated intervals above and below, and these are worked out arithmetically, I mean the value, and in this particular segment there is a value placed on it, and in this particular segment and this particular segment, and the sum of these segments, according to the tests, is the total value as represented in ore blocked out.

Q. These segments, then, were discovered by exploration? A. And tests, yes.

Q. And tests? [40] A. Yes.

Q. When you refer to a blocked-out section estimated at \$409,000, you mean that is a section which has been explored and tests have been made and it is estimated that ore at that value is there to be taken, but it has not been exploited yet?

A. Has not been what?

Q. Has not been exploited? You have not taken any ore out of there?

A. That is partially correct and partially incorrect, because in this exhibit that is here with regard to the blocked-out ore, it shows so many thousand tons on the dump of such-and-such a value, and it shows so much money is represented in each segment or section in the mine.

Q. Then, that four hundred some thousand included ore that had been extracted?

A. On the dump, ready for the mill.

Q. When did you get your mill completed?

A. Sometime in 1947; the exact date I am not familiar with.

(Testimony of Clayton R. Jones.)

Q. There was a substantial investment there, wasn't there? A. Yes.

Q. Do you remember how much?

A. Not without referring to the books.

Q. Do you recall at the end of 1944 you had advanced about \$14,500 and Mr. Higgins had advanced about \$14,500?

A. Approximately. [41]

Q. And at the end of 1945 you had advanced \$55,100 and he had advanced \$54,506; and at the end of 1946 you had advanced \$128,100 and he had advanced \$128,006; at the end of 1947 you had advanced \$157,600 and he had advanced about \$159,506. Is that about correct, as you recall?

A. Approximately, I would say.

Q. What business is your corporation engaged in? A. W. J. Jones & Son?

Q. Yes.

A. It is in the stevedoring and shipfitting business.

Q. Do you recall, Mr. Jones, the board of directors' meeting that was held to confirm the dismantling of the mine by Klamt? A. Yes.

Q. Do you remember that meeting that was held confirming the contract with him? A. Yes.

Q. He was to sell the equipment, and the first \$20,000 received was to be turned over to the company? A. Yes.

Q. To Mina del Refugio? A. Yes.

Q. And he was to keep anything else that he recovered? A. Yes.

(Testimony of Clayton R. Jones.)

Q. Do you recall that at that meeting a resolution was adopted—before the resolution was adopted, the minutes read: “It was [42] pointed out——”

I am reading now from Exhibit 76 which you previously identified.

“It was pointed out that there were outstanding notes of the company, and obligations for advances and equipment sales to it in the aggregate amount of more than \$300,000 which had been issued and incurred to evidence the obligation of the company to repay the loans and advances, and for sales of equipment made from time to time by Mr. Higgins, Mr. Jones and Mr. Dennison Harris and his family.”

Do you remember such a discussion?

A. Yes.

Q. Then, the resolution was adopted:

“Resolved that the officers of the company be and hereby are authorized and directed to make a pro rata distribution to the holders of the outstanding notes and other obligations of the company of any and all funds of the company realized under the agreement with Mr. Klamt confirmed in the letter from Mr. Higgins to Mr. Klamt, dated December 27, 1948, plus any funds of the company on deposit in its bank account after payment of all prior liabilities.”

Mr. Higgins was president, wasn't he, and you were secretary-treasurer? [43]

(Testimony of Clayton R. Jones.)

A. I think I was vice-president.

Q. Vice-president? A. Yes.

Q. Then this resolution was adopted:

“Resolved that the officers of the company be and hereby are directed and authorized to make whatever disposition of the corporate structure of the company that they deem **most advisable**, such authority to include dissolution of the company or abandonment of the corporate structure.”

What was done?

A. The agreement with Mr. Klamt was carried out and a final determination was reached and the money was distributed, and the corporate structure remains a nonentity, I guess you would call it.

Q. Did you take any formal steps to dissolve it?

A. I don't believe it has been dissolved.

Q. Did you take any steps to keep it in existence? A. I cannot answer the question.

Q. What happened to the real property and the mining claim?

A. They are still in the name, on the books, of the Mina del Refugio Corporation, as registered in the State of Sonora.

Q. As far as you know, the corporation is still in existence? It is still owned as a corporation, the land and the mining claims?

A. Well, I am not familiar with Mexican mining laws. I believe [44] if there isn't a certain amount of assessment work done each year the mining rights

(Testimony of Clayton R. Jones.)

revert back to the State, and I would imagine after a year the State would step in and take those mining rights back.

Q. At the time the corporation went in there and took over this property, what was the condition of the mine? You say there was no equipment there——

A. It was being worked. It was a going concern.

Q. Who was working it?

A. Juan Robinson, owner of the mine from whom we purchased it, was working it with ten to twelve men. It was a going concern when we purchased it.

Q. What equipment was there?

A. A railroad track, tram cars, picks and shovels and, I would think, a lot of dynamite and caps.

Mr. Oehmann: I think that is all.

Mr. Oppenheimer: That is all.

(Witness excused.) [45]

JOHN C. HIGGINS

was thereupon produced as a witness on behalf of plaintiff and, being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Oppenheimer:

Q. State your name, please?

A. John C. Higgins.

(Testimony of John C. Higgins.)

Q. What has been your business or profession in the past?

A. Well, I was practicing law in 1902 and practiced law until 1938, and at that time the doctors retired me from the practice of the law and told me to quit the law or anything else in the way of business, and I came out to where I had been raised and had gone to school, which is Oregon, and I have been here since.

After the first six months after their operation on me, I went actively back into the mining business and lumber business, and I continued in the mining business actively until the end of 1948, and in the lumber business until 1948, and I have been in other businesses since, but I have not practiced law since 1938.

Q. You have been interested in underground mining ventures and projects?

A. Yes. I began trying mining lawsuits while I was still in the West before going back to New York to practice, and continued actively in the trial of mining litigation for about twelve to fourteen years, and during that time, which was around from 1912 [46] to 1924, I also participated in the mining business as a proprietor and operator of mining properties and financing explorations and generally, outside of my law practice in the mining business, carried on a mining business of my own, and I continued to do it down until the end of 1948.

Q. How long have you known Clayton R. Jones?

(Testimony of John C. Higgins.)

A. I think the first time I ever met him was when he walked into my office in 1944 here in Portland and introduced himself. I may have seen him or had been introduced to him before, but I never had any relationship with him until he came in to talk to me about this Mexican mine.

Q. The Mina del Refugio.

A. It was not at that time the Mina del Refugio.

Q. It was not?

A. No. That name, Mina del Refugio, had nothing to do with that mine which we were interested in at that time. The Mina del Refugio was a Mexican corporation, merely a structure which we bought a considerable time after we became interested in this property and had begun to spend money on it.

Q. Was it about that time that you met Mr. Denny Harris?

A. Yes; and that was the first time I had met him.

Q. And, so, you discussed with Mr. Jones, and he with you, this mining project in Mexico?

A. That is right.

Q. I will call your attention to Exhibit 55, which is the Trust [47] Agreement, to Exhibit 56, which is the agreement whereby these mining rights were transferred to this Mexican corporation, and to Exhibit 57, which is the agreement between the Mexican corporation, Clayton R. Jones and D. E. Harris and John C. Higgins.

(Testimony of John C. Higgins.)

I think it will expedite matters, Mr. Higgins, if you will just give us the history and course of events in connection with those particular exhibits.

A. This is the first time I have looked at this agreement or at these documents for several years, so I haven't a very good recollection.

Q. Leave out the exhibits, then, and tell us in narrative form what the events were which led up to the culmination of the operation of this mining property.

A. Well, after Mr. Jones had come in and talked to me about the property, and I think Mr. Kroder, who was a promoter, a mine-finder, a fellow who goes out and locates properties and then tries to peddle them and retain an interest in them—after they had described the facts to me, on the facts as they related them and understood them it seemed to me interesting enough at least to justify an examination by mining engineers.

I did not examine the property and, in that situation, since Mr. Jones was suggesting that I take an equal interest with him the understanding that we would have to put up most of the money which was required to carry on, I suggested the employment of two men to make an examination. Mr. Jones left to me who [48] those two men were to be.

At that time I was carrying on an operation in Nevada which was an underground operation on a rather large scale near Virginia City. That property was being operated, as manager, by a man who

(Testimony of John C. Higgins.)

had had a good many years' experience in mining operations, a man by the name of Homer Gibson, who was very familiar with underground work.

Although he was not a graduate engineer, he had studied mining engineering and I regarded him as a very competent man, having practical operating judgment.

I had employed in connection with the Nevada operation that Mr. Gibson was running a man by the name of A. J. Klamt, who was a graduate mining geologist, at any rate a practicing mining geologist, a man of mature years who had spent a lifetime in the mining business.

I suggested that we jointly send Mr. Gibson and Mr. Klamt down to examine this property and to take samples at the property and examine the underground workings—it was an operating property at that time; had been operated on a small family or neighborhood scale, by Juan Robinson, who was mentioned by Mr. Jones, for many years, and apparently had been a reasonably profitable operation for the reason that it had supported the Robinson family and a whole retinue of relatives for many years, as I subsequently found out, on a very primitive basis, operated on a very primitive basis; all of the underground work [49] was hand work. They used jackhammers instead of compressed-air drills. They hammered steel into the face of the rock and, by hand, loaded the holes and blasted out the ore and they carried this ore in sacks on their backs

(Testimony of John C. Higgins.)

from the lower levels of the operation to the surface and there they loaded it in sacks or bags on burros and transported it, I think, a distance of 12, 15 or 18 miles, something like that, to a rail head in that area and shipped it as raw ore to a smelter in Northern Mexico, at a very heavy expense, of course, all the way through, and recovered enough value from the ore—and it had to be a high-grade ore in order to stand those costs involved in that method of operation—to pay a substantial profit and provide a living for a whole retinue of people and the wages of the men who were engaged in the operation over a considerable period of years.

After Mr. Gibson and Mr. Klamt had examined the property, they reported that in their opinion it was a property of substantial value, at least to the extent of justifying expenditures by me and Mr. Jones in further exploration and development, with the idea that before we installed a mill we could extract enough crude ore, untreated, to justify shipping it by truck to the rail head and ship it by rail to the smelter and get enough out of that raw ore, unsorted ore, to make a very substantial profit.

Their estimate, and our estimate on the basis of their reports, was that for a cost to us of no more than \$50,000 [50] we could put the mine into operation on that basis. We would have to buy some little equipment—we would have to buy a compressor which would deliver air to the mine faces below; we would have to buy probably one or two ore

(Testimony of John C. Higgins.)

trucks to transport the ore to the rail head; we would have to equip, on a less primitive scale, at least, boarding houses and living quarters for the Mexican miners who would carry on the operation.

Their belief was that we would have our money back out of the grade of ore that was expected to be there, from past operations, and what was then on the dump and what our men could observe in the faces of the mine—we would have our money back within a period of perhaps five or six months.

Q. What was the grade of ore, for instance?

A. That would depend on the level and the various blocks of ore that were apparent in the underground workings that were accessible at that time, and our belief was that the ore which could be sorted and shipped to the smelter would have a value of around \$40 or \$50 a ton.

Q. Did you eventually acquire these mining rights?

A. We did. Juan Robinson owned the mining rights in—well, there is a group of claims—they have a Mexican term for it which I have forgotten. They had a group of claims, one of which was the Tescalama group or claim. That was the claim on which these mining operations had been carried on by Robinson. One was the Ana Esstela. One was the Bueno or the Noche. I [51] think there were two or three more of them in the group he was offering through this man Kroder and Arthur Johnson, who was a mining manager and operator and who was familiar with the property—he was

(Testimony of John C. Higgins.)

offering to sell leases on the property together with such little equipment as there was — there were shovels and picks and jackhammers. Probably the entire value of their mining equipment, so-called, would not amount to \$1,000.00, but he was offering to sell the leases for \$35,000.00, as I remember. I have not refreshed my memory on it.

Q. Will you look at Exhibit 55 and see if that is the agreement by which you finally procured the option or acquired the mining rights in the name of Mr. Harris?

A. They were to be acquired, first, in the name of Mr. Harris who had been in Mexico a good deal, and who spoke Mexican. He was a friend of Mr. Jones and a business associate with him in a dredging operation here.

I have some vague recollection that at that time he either knew Juan Robinson or very quickly went down or had gone down to Mexico at Mr. Jones' suggestion and met Juan Robinson and was able to talk with him in Spanish and to carry on these negotiations, and we thought that until we organized the Mexican corporation, which we at that time expected to carry on the operation there, that during the interim period Mr. Harris, as Trustee, would take over the option from Juan Robinson for the purchase of the claim. I find nothing in this about the purchase [52] price of the claims.

Q. That was the purchase price of the claims, \$35,000.00?

A. That is my recollection. You are more fa-

(Testimony of John C. Higgins.)

miliar with this record than I am because I have not seen any of these documents for years.

Q. There has been some talk about giving a finder's interest to a Mr. Kroder?

A. That is right.

Q. Thirty-three and a third per cent in the first instance and then that was reduced to twenty per cent, ten going to him and ten going to Mr. Johnson?

A. Yes.

Q. Would you briefly explain that point?

A. Well, when Mr. Kroder first came in, he proved to be a rather tough bargainer. A thirty-three and a third per cent interest seemed to me to be a rather preposterous interest for a man who had invested only a very little time in looking at this property and examining it. He was not a mining engineer; he had no claim to professional standing but was really, just as I thought, a mining promoter. But he stood stiff on the proposition and said he would not arrange for a transfer to us of the leases on these properties for less than a one-third-interest.

After discussing the matter with Mr. Jones, who also felt it was a rather high price, we, nevertheless, thought from [53] what we were being told about the property that it might prove to be something like a small bonanza and, if it was, a thirty-three and one-third per cent interest would not seem to be excessive if, in fact, we could bring it into production, and very profitable production, if

(Testimony of John C. Higgins.)

the actual expenditures on our part were no more than approximately \$50,000.00.

So we agreed to accept those terms initially. I had a very important reservation in my mind as to whether or not we would care to extend any money except the money necessary to send a couple of competent men down there to examine the property, on any basis that would give Mr. Kroder thirty-three and one-third per cent of what might result from the operation, and when the report came in and it was not as glowing as Mr. Kroder's description had led us to believe the property would be, we promptly negotiated with Mr. Kroder—promptly negotiated Mr. Kroder down to twenty per cent instead of thirty-three and a third.

Q. That twenty per cent was then divided eventually as outlined in the testimony of Mr. Jones?

A. Yes. Mr. Kroder had explained he had had an association with Mr. Johnson, who was a mining manager, and gave Mr. Johnson's history.

Neither Mr. Jones nor I knew Mr. Johnson at that time. He said Johnson had been of help to him in connection with this and other mining promotions and that he had an agreement with Mr. Johnson by which they were to split fifty-fifty any [54] finder's commission that they got out of these properties.

Q. As has been testified to here, you eventually acquired the Mexican corporation? A. Yes.

Q. Tell the Court whether you had these mining

(Testimony of John C. Higgins.)

rights before you acquired this Mexican corporation?

A. Oh, yes, a considerable time before. I told Mr. Jones, when he came in with this proposition, and Mr. Kroder also, that personally I would not undertake an operation in Mexico except under very competent Mexican legal advice, and shortly after—I don't remember how long after—we had a report from Klamt and Gibson as to their opinion about the property, suggesting that they thought it amply justified initial expenditures on our part to put it into operation or at least \$50,000.00, with the prospect of our getting that money back very quickly out of bonanza ore. I got the recommendation—it perhaps came from Mr. Harris,—I am not sure,—or it came from Mr. Johnson—as to a Mexican lawyer, qualified to practice both in the United States and in Mexico, by the name of Malcolm Little, at Nogales, Arizona, right on the border. I have never been in his office, but his office may be on the American side of the line, or perhaps it is on the Mexican side, because most of his practice was in Mexico, and most of it related to mining operations.

I got some outside information as to Mr. Little and the information was favorable as to his reliability and competency [55] and particularly as to his skill in connection with Mexican mining legal matters, and I got in touch with him on the telephone and then in correspondence with him, and my reactions were entirely favorable. He seemed to be an

(Testimony of John C. Higgins.)

intelligent lawyer and knew the answers, as far as Mexican law was concerned, and I asked his advice.

I told him we had planned to organize a Mexican corporation to carry on this operation, because there were other parties than Mr. Jones and myself. If it had not been for this outside participation, Mr. Jones and I would have started as an operating partnership down there.

Mr. Little advised me strongly not to attempt to operate down there as an American partnership and not to attempt to organize a new Mexican corporation and certainly not an American corporation to carry on an operation down there.

He said, "Under present Mexican laws, if you organize an American corporation you probably cannot be qualified to operate down here at all. You would have to organize a Mexican corporation, and if you organize a Mexican corporation the present law would require that fifty-one per cent of the stock be owned by Mexican citizens."

Since we had no Mexican citizens at all in the picture who would put up any money or with whom we wanted to be associated in such an ownership or operation, and since it would be up to Mr. Jones and myself to put up most of the money that would be [56] required, I felt stymied. I said, "What are we going to do in this situation?"

"Well," he said, "it is the practice among Mexican lawyers," and he said, "I am a qualified avocat down there—" or whatever they call them. He said

(Testimony of John C. Higgins.)

it was the practice among lawyers, as far as practical operation was concerned, to preserve in their offices the Mexican corporate structure and he said, "I happen to have such a Mexican corporate structure that is set up as a mining operation which can actively carry on mining exploration and a development program," and which he said had, some years ago, proved to be unsuccessful, but, he added, "I have since that time kept up the annual taxes and fees that have to be paid to keep such a corporate structure alive, and it is alive and a going and qualified corporation," and he said, "It has cost me a substantial sum to keep it alive"——

Mr. Oehmann: If your Honor please, this is all very interesting and educational, but I don't think it proves what happened in 1948. It is encumbering the record with a lot of immaterial testimony.

The Court: Continue in your own way, Mr. Higgins.

A. It seems to me, if your Honor please, it has a great bearing on the issues here.

Mr. Oehmann: I object to Counsel arguing at this point. He is a witness now.

The Witness: I would not be proceeding with this testimony [57] if I did not believe as a lawyer that it has strong bearing upon the contentions involved in the case.

Mr. Oehmann: You realize, too, Mr. Higgins, that it is the Court which decides what evidence is admissible.

The Witness: Of course, I do. I, of course, sub-

(Testimony of John C. Higgins.)

ject myself to the judgment of the Court as to whether I should proceed or not.

Q. (By Mr. Oppenheimer): Just proceed with your narrative.

A. I said, "What would be our situation if we purchased from you, if that is what you propose, this corporate structure?"

He said since that corporation was organized—I think he said in 1932, long before the recent statute was passed which required operating Mexican companies to have at least fifty-one per cent Mexican ownership, "The corporation, if you operate under that name, and purchase the corporate structure and continue it, the corporation will not need to be owned fifty-one per cent or any per cent by Mexican shareholders, and you and your associates, Mr. Jones and others, can, therefore, operate in Mexico free from any such restrictions, and your position before the Mexican courts would be vastly more secure than it would be if you organized a new corporation or if you attempted to operate here as a partnership or as an American corporation."

Q. You eventually acquired this corporate structure that you speak of?

A. Yes. In addition to fees for his advice in the matter, I [58] think we paid Mr. Little \$500.00 for the corporate structure.

Q. Prior to that you had acquired these mining rights? A. Oh, yes.

Q. What became of these mining rights?

A. The mining rights had been acquired in Mr.

(Testimony of John C. Higgins.)

Harris' name as Trustee, and he transferred them to this corporation, the name of which was Mina del Refugio.

Q. State to the Court whether or not those mining rights which were acquired had a substantial or nominal value?

A. They had, in our opinion, a very substantial value, or we would not have expended the substantial amount of money that we did in attempting to develop them and put them into operation.

Q. You were familiar with the eventual sale of the interest of the finders in the stock of Mina del Refugio?

A. Yes. I remember Mr. Jones and I purchased Mr. Johnson's stock, which I think was nine per cent, if I remember correctly, the total corporate stock, for \$4,000.00, when he was in the hospital in Tucson, Arizona, about to die from cancer, and I know Mr. Kroder sold his stock to Mr. Wells and one or two others in New York City for approximately the same amount—\$5,000.00, I think.

Q. That was after these mining rights had been transferred to the Mexican corporation?

A. That is right.

Q. In this original agreement that you have in your hand, Exhibit 57, and I think in the trust agreement, Exhibit 55, in [59] actual practice, the advances made by Jones and yourself were loans to the corporation; the moneys you advanced were represented by promissory notes of the Mexican corporation?

(Testimony of John C. Higgins.)

A. That is not quite fully true, Mr. Oppenheimer. When we bought the corporate structure,—it was a strange practice to me but one which seems to be common in Mexico, from Mr. Little—obviously, the capital stock of the corporation had not been paid up. It was only 5,000 pesos, or approximately \$1,000.00 in American money, and we, of course, would not start operating under a corporate structure or corporate name whose capital stock had not been paid up, so that a thousand dollars of our money was paid to pay up the par value of that corporate stock, and it was put into the company and was not represented by any note or obligation of Mina del Refugio to Mr. Jones and myself.

Q. This \$1,000.00 was in addition to these mining rights that had been transferred from Mr. Harris, as Trustee?

A. Yes, that had nothing to do with the transfer of the mining rights from Harris, except that it was the company from which the rights were transferred.

Q. So there were two separate transfers; namely, the \$1,000.00 plus the mining rights?

A. That is right.

Q. Coming back to my question which was not complete, about subsequent advances made to the corporation, by virtue of these exhibits, would you please outline the circumstances under which [60] notes were to be given by the corporation, the Mex-

(Testimony of John C. Higgins.)

ican corporation, to Jones, Harris and yourself, as and when you advanced money?

A. Well, as the proposition started out, Mr. Harris said his advances to the company would have to be limited to \$3,000.00, because he felt that was all he could invest, even though these properties looked attractive, and it was therefore understood between Mr. Jones and myself and Mr. Harris that we would ourselves provide the necessary moneys to carry on the operations and to start additional exploration of the properties underground, additional development, to find and block out such ore as could be found and to provide necessary equipment, originally just mining equipment and subsequently milling equipment, to mill the ore because it was found within, I would say, a year at least after the operation started, that a mill would be necessary because the cost of trucking raw untreated ore from the mine to the rail head and pay freight on it to the smelter was too great to be borne by the lower-grade areas in the mine, and there were very substantial lower-grade areas where the ore was commercially—where it would be profitable according to the engineers' reports, and we found in the course of operating, if the ores were first treated in a mill at the property and concentrates produced which would have a very high value per ton and which would stand the cost of trucking to the rail head and freight to the smelter, and which could be treated at a lower cost at [61] the smelter. That

(Testimony of John C. Higgins.)

was the basis upon which we subsequently proceeded.

(Recess.)

Q. (By Mr. Oppenheimer): Were advances made by you and Mr. Jones to the corporation, the Mexican corporation, Mina del Refugio?

A. Yes, very substantial advances.

Q. And were these advances represented by any particular document or documents?

A. Well, it was agreed from the very beginning in the written contract that we executed with Kroder and all the way through that our advances to the Mexican corporation to be organized should be represented by notes of the corporation, issued at intervals, notes issued to us from the advances up to date, the notes being repayable, as I remember it, within two years from the date of the notes.

Q. I will ask you to state whether or not it was your intention that those notes should have been paid by the corporation according to their tenor on or prior to their due date?

A. Our expectation was that we would get back our maximum of investment of \$50,000.00 in these preliminary costs within a period of approximately six months. That proved to be a wild dream ultimately, but it was the dream that we were dreaming at the time we first became acquainted with this property and had some information about it.

Q. You did advance substantially more than \$50,000.00, did you? [62]

(Testimony of John C. Higgins.)

A. Eventually we advanced over \$300,000.00.

Q. Those advances were represented by notes?

A. All of them, as nearly as I remember, excepting that there were current cash advances, expenditures paid by Mr. Jones in connection with his various trips to the property, and he went down to the property many times. I went only once in the whole period during which we were connected with it, and that was rather late after the mill had been erected and was in operation——

Q. Will you explain to the Court——

A. May I finish the answer there?

Q. I beg your pardon.

A. So that some of these advances that were made by Mr. Jones and many that I made were not represented by notes. That came under a clause of the agreement, as I remember it, that until notes were executed for advances that we had made the advances were to be regarded as open accounts and they were payable as debts of the corporation and if we were repaid before the note was issued, of course, we did not get a note, also; we merely got repayment of the advances that we were each putting up all the time on the Company's business.

Q. I wish you would develop the background of the reason why notes were issued for these advances.

A. When this first contract was made with Mr. Kroder on July 31, 1944, which is Exhibit 53 in this case, it was agreed that [63] if we decided to go into this proposition we should put up the \$35,000.00 that was the purchase price of the Tescalama group

(Testimony of John C. Higgins.)

of claims owned by one Robinson, and that for that \$35,000.00 we should receive notes that were repayable within two years from their date with interest at five per cent, and then when the subsequent agreements were made, and when it became apparent from further investigation that, in addition to this \$35,000.00, which was not all payable at once—only \$10,000.00 was payable at once; the balance of it was to be paid out of royalties on the ore, with a limitation of three or four years during which annual installments of, I think, \$10,000.00 had to be paid.

In order to make those payments, so that we would thereby be putting in the corporation's ownership the group of mining claims, estimated by us to be worth certainly the purchase price of \$35,000.00, we advanced that in order that the corporation might have that, as you might say, as surplus capital.

We were businessmen enough to realize that this corporation to which we were transferring this option on these claims, and the purchase price which we were making, if the corporation was to operate in Mexico as a Mexican corporation it had to own the mining grounds on which it was operating, and in order that it might own the mining grounds and that it might still retain possession—that we might retain our possession as against Mr. Kroder and Mr. Johnson owning one-fifth of the stock of the corporation, we did not propose to be turning over [64] to Mr. Kroder and to Mr.

(Testimony of John C. Higgins.)

Jones one-fifth of the money that we were investing in this corporation.

Q. You said Mr. Jones. Didn't you mean Mr. Johnson?

A. Mr. Johnson and Mr. Kroder, yes.

Q. Let's stop there for just a minute. In other words, Kroder and Johnson had these finders' interest, which was first thirty-three and a third per cent and later reduced to twenty per cent?

A. That is correct.

Q. As I understand, the cash advances you were making—you did not want them to participate in those cash advances by virtue of their finders' interest in the corporation?

A. Not until after we had been repaid the moneys that we were risking in this venture because it was a venture from the very start. We knew that, and so did they. It was not an investment.

Q. How did that place you in relationship to other creditors of the Mexican corporation?

A. It was equal with any other creditors that there might be. There have never been any other creditors of the corporation, except for very temporary periods for current supplies, such as groceries for the boarding house and powder and other current mining supplies, because Mr. Jones and I advanced—as rapidly as any such obligations of that sort would accumulate, we advanced money to pay for those claims. We advanced money to pay the wages of the miners on the property, and we kept it free and clear of all current obligations to

(Testimony of John C. Higgins.)

other creditors, except things [65] that could not be paid at once. There were taxes that had to be paid at periodic intervals; there were always some obligations held back, but Mr. Jones and I each regarded ourselves in the situation as in a position where we had to pay other creditors in order to continue, of course, this operation, and in order to protect the money which we hoped to get back at some time from the notes of the corporation.

Q. In other words, you and Mr. Jones advanced, as requested, money to pay any claim for labor or whatever else it might be?

A. That is right, and when these operations were wound up there were no other creditors except Mr. Jones and myself. We paid everybody but ourselves.

Q. You stated in your testimony a while ago you expected your advances, which you estimated at best to be \$50,000.00 but which climbed to some \$300,000.00 eventually, to be repaid in a short period of time, and I think you used the words "bonanza ore."

Maybe I misunderstood that, and perhaps the Court is familiar with the term. I wonder if, just for the purpose of the record, you would tell what is meant by "bonanza ore," and whether it has any particular significance?

A. Well, normally it is considered to mean rich shipping ore that won't have to be treated in a mill, and that will pay a very substantial profit over and above mining and transportation and smelter costs,

(Testimony of John C. Higgins.)

and bonanza can run all the way from \$30.00 or \$40.00 a ton to \$300.00 or \$400.00 a ton. I have never been in on any [66] of the \$300.00 or \$400.00 ton bonanza ore.

Mr. Oppenheimer: I think you may cross-examine.

Cross-Examination

By Mr. Oehmann:

Q. It was you who addressed the letter of December 27, 1948, Exhibit 75, to Mr. Klant, was it not, in which you enclosed the contract he was to sign covering the manner in which he was to dismantle the property?

A. I signed it, and I usually compose any letters I sign.

Q. Then you composed Paragraph 3 which reads:

“By December 31, 1948, if posible, or as soon thereafter as it can be accomplished, you are to pay from the Company’s funds on hand, or in bank, all of the Company’s outstanding accounts, pay rolls and liabilities, and you are to transmit to the Valley National Bank the full balance of any funds then on hand in Hermosillo for deposit in the account of Mina del Refugio, S. A., except that you retain, as a revolving fund, in the bank at Hermosillo, a balance of 5,000 pesos, or its equivalent in United States currency.”

You recall that?

(Testimony of John C. Higgins.)

A. Yes, very clearly.

Q. You recall, too, that he was to dismantle the property and sell it, subject to approval by you and Mr. Jones in certain [67] cases where the costs exceeded \$500.00?

A. That is correct.

Q. And send to you the first \$20,000.00 received for such sale, and retain the balance?

A. That is correct.

Q. You also recall at the Board of Directors' meeting a resolution was adopted to the effect that all prior liabilities be satisfied and then this \$20,000.00—I think it was estimated it might be \$22,500.00 before it was finally wound up—be distributed to the note holders?

A. That is correct.

Q. There were creditors, then, who took precedence, or who were prior to you note holders?

A. No, there were no creditors prior to the note holders, with these exceptions. Of course, under Mexican laws, current pay rolls, just like under our laws here, were prior charges against the Company's assets, and we had no idea of running out from under the Mexican laws and attempting to extract any money from this company or its properties without meeting all requirements of the Mexican laws. In addition, there were always taxes of various sorts that accrued during the operation and which should be paid from the Company's assets, so that as far as prior claims of that sort are concerned, of course, there were prior claims, but no claims as general creditors of the Company. Let's

(Testimony of John C. Higgins.)

say anyone that provided supplies for the Company or provided powder for [68] the Company, or provided supplies for the Company's ordinary operations or sold equipment to the Company, they were on a parity with us. We were creditors just like they were and on the same basis.

However, I told you we did see that every claim of that sort was paid so that when this corporation ceased its operations in Mexico there wasn't a creditor besides ourselves.

Q. Let me ask you this: You recall Mr. Jones identified Exhibit 64, which is a letter to Mr. Wells in New York, dated May 16, 1946, in which Mr. Jones indicated that "it would cost \$500,000.00 for our interest."

Do you recall there being testimony to that effect that at that time he considered your interest?

A. What was the date of that letter?

Q. May 16, 1946.

A. Yes. I recall the letter, and at that time we thought the property was worth that much. We would not have sold it for less.

Q. At that time you had invested, you and Mr. Jones, something like over \$100,000.00?

A. I think a good deal more than \$100,000.00 at that time.

Q. Mr. Jones—and I assume you are familiar with the fact that he knew about it—testified they had blocked out sections of ore, or there was ore blocked out, which had been valued at \$409,000.00?

A. \$409,000.00; I think that is correct, yes.

(Testimony of John C. Higgins.)

Q. So, then, we read the next to the last paragraph of this letter, Exhibit 64: "This figure mentioned may seem very large, but the ore that we have blocked out, together with our present investment, does not make it look so exorbitant."

Doesn't that mean that the \$500,000.00 which you and Mr. Jones considered your investment to be worth at that time consisted of the cash advanced plus \$409,000.00 in the way of ore discovered and tested and ready for exploitation?

A. Yes, but you should understand this, that that \$409,000.00 of blocked-out ore does not mean that is all profit—does not mean that your profit after mining and milling and smelting of that ore is going to be \$409,000.00. That was the gross value of that ore, and it would have to be valued on the basis of a probable margin of profit.

In addition to that there was in the property at that time, according to the reports from our engineers, other very substantial blocks of unexplored ore which could practically be projected certain distances beyond the faces of the workings, so the ore value in the property was by no means at that time defined as \$409,000.00 and no more.

But I, at least, had in mind at that time in assenting to an offer of that sort to Mr. Wells, that the property would go to Mr. Wells or his associates or whoever might be willing to purchase it under those circumstances, free and clear of the [70] payment of these loans by Mr. Jones and myself, and our profit, under those circumstances, would not, of

(Testimony of John C. Higgins.)

course, have been \$500,000.00. It would have been the difference between what we had advanced and what was owed to us from the Company and \$500,000.00.

Q. Do you recall, in March, 1946,—March 25, 1946, to be exact,—when you wrote the letter identified as Exhibit 63 to Mr. Johnson, referring to his illness—

A. Yes.

Q. And expressing your regret—

A. Yes.

Q. —acknowledging receipt of an executed copy of his assignment of his stock or his interest in the corporation, in which you also told him he had the right to repurchase it within a year, I think it was?

A. That is right.

Q. Personally?

A. Yes.

Q. Limited to him alone?

A. Yes.

Q. You paid \$400,000.00 for that, did you not?

A. Yes, that is my recollection.

Q. But it was after you and Mr. Jones had invested considerably over \$100,000.00?

A. Well, my recollection of our investment at that time would [71] be—yes, very much over \$100,000.00. In purchasing this stock from him for \$4,000.00, we considered that it was worth that and he was the man who made the offer to sell it for \$4,000.00. We thought it was worth certainly that much, subject to these debts of the corporation.

Q. The same thing was true of the other stock you acquired, was it not? Did you acquire the Kroder interest, too?

(Testimony of John C. Higgins.)

A. No, that was sold to Mr. Wells and some relatives or friends of his in New York City. No, we did not purchase that.

Q. But Mr. Wells indicated in this Exhibit 60 that he agreed to pay \$5,000.00 for it?

A. That was our understanding as to what he paid for it, yes.

Q. That was in April, 1945. You indicated that you expected a maximum investment of \$50,000.00 would carry the Company through, what was it, the first six months? A. The first six months.

Q. The time necessary to produce ore in profitable quantities?

A. Yes. Our expectation was that during that first six months the Company would, from shipping ore, make enough to repay our \$50,000.00 and provide any additional money that was necessary for further development of the property and equipment of the property with a mill so that we could keep on shipping and that we would not be required to build a mill or make any advances beyond the first \$50,000.00, \$10,000.00 of which would go to the payment of the first installment on the lease, option of purchase, and the [72] balance of which would go into the mining operations for the production of ore.

Q. But the balance was to come from royalties?

A. The balance was to come from royalties with the provision that we felt the further balance of \$25,000.00 must be paid within a period of three or

(Testimony of John C. Higgins.)

four years after that, which meant that if it did not come from royalties we had to pay it anyway.

Q. If you expected a profitable return in six months, you did not expect to have to pay that balance out of your own pockets?

A. No, we did not expect to pay that balance out of our own pockets or anything further than our first \$50,000.00.

Q. Then you discovered you would have to increase your investment? A. Yes, we did.

Q. You increased it to the extent finally of about \$150,000.00?

A. My investment in mining equipment, which I furnished and shipped to this property from other operations,—my investment ran to approximately \$165,000.00, but I did not take notes from the corporation for the mining equipment, I think more or less just because of carelessness on my part, although under the terms of the contract I was protected, because it required that the company would repay the reasonable value of the mining equipment, just as though they had issued notes for it.

Q. How much in notes did you have at the time of the abandonment?

A. I would have to look at the record for that. I haven't seen [73] the records for years.

Q. Could it be approximately \$150,000.00?

A. I would suppose so. That is my recollection.

Q. What did you do with your notes?

A. I kept them until I sold all of my mining

(Testimony of John C. Higgins.)

operations in the year 1948, in December of 1948, to a group of men in Spokane. At that time I was carrying on active dredging operations, with one dredge operating in Montana and a dredge operated and a mill operated producing tungsten concentrates and one dredge operating in Idaho, and I sold all of them to this group in Spokane.

I should say, so that you may understand clearly what the situation is, that on the 1st of October, 1948, instead of carrying on all my various mining investments and operations as an individual I organized a corporation called the H & H Mines, Inc., an Oregon corporation, with a capitalization of, as I remember, \$300,000.00 in par value. I transferred the Montana dredging operation and mill there and the Idaho dredging operation, with the camp buildings and other equipment and the Mina del Refugio notes and my claim against Mina del Refugio for the purchase price of the mining equipment that I had shipped down there, which belonged to me, to this corporation. The doctors advised me that I must quit working so hard or I would kill myself, so I was anticipating an early death at that time if I did not quit working so hard and did not quit attempting to manage [74] so many different operations, and I set up this corporation and transferred all of my mining assets to the corporation.

Q. I hope that anticipation of early death has been as wrong as your expectation of a profit in this mining corporation.

A. At any rate, it is two years or two and a half

(Testimony of John C. Higgins.)

years since that time and I am still here, but I have not been working as hard in the last few years as I did before.

Q. Did you own the H & H Corporation, Mr. Higgins?

A. I owned it a hundred per cent, yes; that is, when I incorporated it on October 1, 1948, I owned all the assets. They were transferred to it in payment of its corporate stock.

Prior to that time I had operated under the name of H & H Mines, not incorporated, but as the H & H Mines, for a period of at least ten years. During part of that time I was not here personally. The operations were managed by Mr. G. S. Hinsdale, who initially took a 10 per cent interest in the partnership enterprise known as H & H Mines, but he shortly regretted his purchase of a 10 per cent interest for a very small amount of money, because it was in the early days of the operation, and he wanted his money back, and I gave him his money back and continued to operate as H & H Mines, the name which was adopted for the partnership, and on all my books, papers and my contracts the name is John C. Higgins, doing business as H & H Mines, until the incorporation, until we incorporated in October, 1948. [75]

Q. After the incorporation in 1948, when did you transfer your Mina del Refugio notes?

A. I think immediately. That is my recollection. I would say on the 1st of October, 1948.

(Testimony of John C. Higgins.)

Q. Is that company on an annual basis for reporting, do you know?

A. Well, it is owned by mining operators in Spokane. They have been carrying on dredging operations ever since.

Q. No. I am asking you about the H & H Mines, the corporation which you say you owned in 1948.

A. Yes. I don't remember as to whether or not we started the fiscal year from October 1, 1948, until September 30, 1949, or whether we made returns on the basis of the fractional year; I did not make the return because by the time the return time came, even if it was for the fractional year or the three-months' period, that return was made by the people in Spokane. I sent the books up to them and they made whatever return their counsel advised them to make.

Q. Do you recall whether or not that company, that corporation, claimed that they had a bad debt deduction for these Mina del Refugio notes?

A. Certainly it did not.

Q. Do you know that to be a fact?

A. Yes, I am sure of that.

Q. Do you know that is what the returns reflected? [76]

A. No, but I know that there would be no basis for such a claim.

Q. You are assuming that, aren't you?

A. Well, yes.

Q. You do not know it to be a fact? You are assuming that they did not claim a loss, aren't you?

(Testimony of John C. Higgins.)

A. From my conversations with them and their counsel, I know that they would not attempt to claim that was a loss.

Q. What is the basis for that knowledge?

A. What is it?

Q. What is the basis for that knowledge?

A. Because during long negotiations with them I explained what the situation of the Mina del Refugio was.

Q. When did you have those negotiations?

A. In December of 1948. That was after we had decided to dismantle in Mexico and had ourselves abandoned this as a going operation, and I would not sell to anyone, an individual or any other, and tell them that was a good operation or a doubtful one. I told them I thought they would get approximately \$10,000.00 from this salvage operation from the selling of the equipment down there, and they did get something over \$10,000.00 as their share.

They had no expectation or belief that what they were getting from me or this corporation, H & H Mines, Incorporated, was worth more than what would be produced by the salvage operation, selling the equipment down in Mexico. When the matter was [77] finally closed, I showed them the contract with Mr. Klamt, so that they knew what to expect from this operation. They could not claim it as a loss, under the remotest possible circumstances, in my opinion as a lawyer. I am not a tax lawyer, though.

(Testimony of John C. Higgins.)

Q. When did you dispose of your interest in H & H Mines, Incorporated?

A. I think the closing of the sale was in the latter part—I know it was in the latter part of December. I don't remember the exact date. I would say the 20th or 21st or 23rd, somewhere along there, about a week before the end of the year.

Q. In any event, you would not have gotten anything from the dismantling of the mining equipment?

A. Personally, no, because I had sold my notes and my claims against the Mina del Refugio, transferred them to H & H Mines, and then I had sold all my stock in H & H Mines to the group in Spokane.

Q. Yes.

A. I am not in any way interested in this controversy in the remotest degree, that I can see.

Q. The property wasn't dismantled and sold until 1948, was it?

A. He began the dismantling, as I recall it, about the 1st of December, 1948, began trucking the dismantled equipment,—that is, the operation of trucking the dismantled the equipment, over impossible roads, more than a hundred miles from the mine to Hermosillo and our corral, consuming a period of several months, [78] as I remember.

Q. You did not authorize him to make any sales until December 27th, that December 27th letter?

A. I think we had a verbal arrangement that if he found any purchasers for any of the equipment

(Testimony of John C. Higgins.)

or, rather, if he could sell small items of equipment, that he was free to go ahead and do it, checking with us before he did so, unless the amounts were very small.

I think the written agreement represented, in substance, as far as the selling of the equipment is concerned, just what was finally included in the letter, the formal letter which I wrote to him in the latter part of December.

Q. For your information, this letter, which is a part of Exhibit 75, starts out with:

“This will confirm the agreement Jones and I, as officers and directors of Mina del Refugio, S. A., made with you over the telephone today concerning the dismantling of the mill.”

A. Yes.

Q. That was written December 27, 1948.

A. This agreement covers more ground than our verbal arrangement with him that he could go ahead and sell some supplies or equipment, by reason of the fact that we had not made a written arrangement with him. Up to the time of this agreement he was not operating on any arrangement by which he would go over a [79] certain figure. We had an idea up to that time that the equipment might produce quite a good deal more than what was finally written into this agreement.

We had come to the conclusion that his attempts to locate purchasers for various pieces of equipment were moving pretty slowly and the expenses of the salvage operation and the trucking operation would

(Testimony of John C. Higgins.)

be so heavy that by the time he had paid them out of the proceeds of the property there would not be anything more than about \$20,000.00 in salvage value left, except probably enough to pay his salary during the period that he was carrying on this operation. He was much more optimistic and thought he could sell it for substantially more, which would give him some real compensation, if he stayed down in Mexico and attempted to carry on the salvage operation.

Q. This money you had put into the mine was a risk venture, wasn't it?

A. Oh, of course. All mining ventures in that stage are risk ventures. There is no doubt about it.

Q. It is the type of investment which pays a high return if it is successful?

A. It is not an investment, sir. It is not an investment at all. You are just gambling your money.

Q. Do you gamble your money without any expectation of return?

A. No. I expected after what we had heard about this property it was worth paying the costs of an examination. After the [80] examination had been made by our representatives, I thought it was worth the additional gamble of \$10,000.00 to pay the first installment on the mining option and thirty or forty or fifty thousand dollars more to get it into operation, so that we could ship some of this high-grade ore.

Q. But it had to be gotten into operation first?

(Testimony of John C. Higgins.)

A. Oh, of course, somebody had to do it, and there didn't seem to be anybody around willing to risk his money to that extent, except Mr. Jones and myself and Mr. Harris, who was willing to risk a few thousand dollars.

Mr. Oehmann: I believe that is all.

Redirect Examination

By Mr. Oppenheimer:

Q. Mr. Oehmann spoke to you about Exhibit 75, dated December 27, 1948. I call your attention to Exhibit 74, a telegram under date of November 15, 1948, and ask you whether or not——

A. I will get it. Maybe this is against the Court's procedure. I am sorry. I will keep my place on the witness chair.

Mr. Oppenheimer: You can charge that to me, your Honor.

A. Yes. This does refresh my recollection, that in the middle of December when Jones and I—or, rather, the middle of November, 1948, when Jones and I had jointly decided that this thing should be wound up, that our efforts to sell the mill in place and sell the mining claims themselves would be fruitless [81] and that it would not justify our continuing to keep the equipment—to keep a crew at the mine and keep the claims there in the expectation that we might sell. We decided to dismantle the mill and have all parts trucked into Hermosillo, and suggested that he bring certain portions of the

(Testimony of John C. Higgins.)

equipment in first and advertise the quantities and sizes and so forth in the Hermosillo paper, and telegraph offers to us in Portland for confirmation.

That was before we attempted to make any agreement with him under which he would carry on the liquidation operations and participate in the proceeds over and above the amount to come back to us.

Q. One final question: These advances made by you and Mr. Jones, represented by notes or by open accounts, you expected those to be repaid to you like any other creditor of the corporation?

A. Yes. The whole plan of advances to the corporation was set up under the advice of Mr. Little, the Mexican counsel, who told us, when in discussion with him, after he had advised us to purchase the corporate structure of Mina del Refugio and carry on this operation under that corporate organization—when I suggested, well, 5,000 pesos or \$1,000.00 seems adequate capital. Of course, it would take a great deal more money than that. Why not file amended articles of incorporation, with increased capital stock?"

He said, "I advise you not to tamper with this corporate [82] structure in that way, because we are still uncertain of what might happen here in Mexico as to the use of these old corporate structures when the courts come to interpret the recent statute which requires that such operations be fifty-one per cent owned at least by Mexican citizens. Leave this structure as it is and provide your

(Testimony of John C. Higgins.)

money to the corporation by loans to the corporation. You will then be in the position of creditors and you won't find yourselves in a situation here, after putting in a substantial investment in the situation, in the unfortunate position of a great many American mining and oil men in the '30s, when the Communists moved in and took over a great many mining operations just under the claim that they were organized as local labor authorities, and they just shoved the owners of the property out."

I happened to be one of those owners at that time. I had property in Chihuahua. The crew just walked in one morning and said to my superintendent, "You are out. We are going to run this property from now on," under such-and-such a decree, I think of the local mayor or local city council or something of the sort.

Q. And you were out?

A. I was out, and I left my equipment there and I never went back—never undertook another mining operation in Mexico until this came along. This looked good enough to justify the risk of such an operation. [83]

Q. One other thing: I understood you to testify as to why you made these loans that you did not want the finders to participate in the cash you and Jones had advanced.

A. That is correct. Mr. Little advised us, when I suggested at that time that perhaps we could handle that by amending these articles of incor-

(Testimony of John C. Higgins.)

poration and providing for preferred stock, he said, "No, that is not good business down here. You keep your investment in this venture in the form of loans to this corporation which you have vested with the ownership of these mining claims. You have really already contributed to its capital what is probably worth a good deal more than \$40,000 or \$50,000, if your reports on these claims are true, so don't risk any more money in that way. You get your money back. Keep yourselves in the position of aliens, as citizens of the United States, in the position of creditors, not of stockholders in a Mexican corporation for a large amount of money, because I can't advise you," he said, "what will happen to you if we have another feverish period such as we had in the '30s down here."

Mr. Oppenheimer: I think that is all.

Recross-Examination

By Mr. Oehmann:

Q. Then you recognized the \$1,000 you paid in, or the 5,000 pesos, was inadequate capital, didn't you, Mr. Higgins? [84]

A. It was inadequate in the sense that it was not anything like as much money as this company would require to operate, and it was obvious that the company would have to raise money in some other way, by loans or otherwise.

Q. Your first reaction was to issue more stock?

A. To issue more stock, but when he explained

(Testimony of John C. Higgins.)

the dangers of such operation, under the then current situation under Mexican law, and advised us to put in the money by loans and notes, I accepted his advice and thought it was good advice.

Q. He told you to keep your investment in the form of loans?

A. He told us to keep the obligations or the money that we put up in the form of loans, yes; if you want to call it an investment, I invested in the notes of this corporation on the faith of the option which it then owned for the purchase of these valuable mining claims. We thought we would get our money back out of that.

Q. Let me ask you this: You heard Mr. Jones' testimony as to the agreement that ten per cent of the stock would go to Johnson, ten per cent to Kroder and the remaining eighty per cent would be divided between you and Mr. Jones?

A. Mr. Jones, myself and Mr. Harris.

Q. And Mr. Harris? A. Yes.

Q. On the basis of the investment and contributions you made towards the operating expenses, the purchase of equipment and [85] the operation of this mine? A. That is correct.

Q. Through the years involved that is just what happened, is it not? Didn't you make contributions in ratio to your capital stock holdings?

A. No, not at all. Ultimately we were to get, as our share of the capital stock, such portion of the capital stock as represented the proportion of these loans that were made by Jones, Higgins and Harris.

(Testimony of John C. Higgins.)

Q. Yes. You did contribute just as much as did Mr. Jones? A. More.

Q. Substantially?

A. More; not much more, but some more, if you want to be accurate.

Q. In other words, you contributed about \$168,000 and, he, about \$155,000, in round numbers?

A. I think those are the round figures.

Q. Your stock percentage was just about the same, wasn't it, thirty-nine per cent?

A. Well, no, I think there was some difference in our numbers of shares of stock.

Q. All right. What was the difference?

A. I don't remember. I haven't seen these files. I can't tell you what the difference was.

Q. You recall all these other provisions of this agreement, don't [86] you?

A. No, I don't. There are many of them that I do not recall at all. If you will refresh my memory as to what the proportion of stock was, I can tell you whether or not we carried out our arrangement.

Q. Don't you recall the agreement whereby you were to——

A. Do you want to develop I did not get as much stock as my proportion of the loans provided for? If you do, if that is the point, I could concede it on that basis, subject to check with the record.

Mr. Oehmann: I move that be stricken, your Honor.

Q. I invite your attention to Exhibit 59, Mr. Higgins, and to Paragraph 4:

(Testimony of John C. Higgins.)

“It has been agreed by and between the parties hereto”——

A. What is the exhibit and what is the date of it?

Q. Exhibit 59, dated March, 1945, entitled “Agreement,” signed by Clayton R. Jones, John C. Higgins and the three Harrises. A. Yes.

Q. It was identified both by you and Mr. Jones. Read Paragraph 4. I will read that paragraph:

“It has been agreed by and between the parties hereto that ten per cent of the stock of the aforesaid corporation shall be issued to Arthur E. Johnson, or his assigns, ten per cent to Daniel D. Kroder, or his [87] assigns, and the remaining eighty per cent of the stock of said corporation shall be divided between Clayton R. Jones, John C. Higgins and the above-named members of the Harris family, in proportion to their respective contributions in cash and in equipment, at its reasonable value, and that such stock shall be so distributed when the total of such contributions, as finally made, has been determined.”

A. Yes. That was not finally made and determined until after 1948, as a matter of fact.

Q. As a matter of fact, you did carry out the spirit of this agreement in that each of you held substantially the same interest in this corporation from 1944 to 1948?

A. I don't remember what the situation was dur-

(Testimony of John C. Higgins.)

ing that time except that in these Mexican corporations their stock frequently is "bearer" stock. All the stock of this corporation originally, I think, and even after we came in, was issued as "bearer" stock. They had to hold stockholders' meetings down in Mexico and, in order to qualify at all down there, since Jones and I did not go down to vote as stockholders, I think we followed the practice of leaving "bearer" certificates in the possession of Mr. Little, our attorney down there, and so we did not, until some later period, according to my recollection, attempt to make any distribution of the stock amongst ourselves, in the sense of taking physical possession of the "bearer" certificates. That is an offhand [88] recollection of the transaction, a transaction that has a great many details.

Q. If I told you that according to the records that are here in evidence you held 2,256 shares and Mr. Jones held 2,156 shares, would that be about right? A. I held what?

Q. 2,256. A. Yes.

Q. And he held 2,156?

A. Well, I would suppose that might represent the proportion of my advances to the Company and my notes, as compared with his, but I have no offhand recollection.

Q. It represents your stock ownership?

A. Well, it was the agreement we should have stock in proportion to the advances we made.

Mr. Oehmann: That is all.

(Testimony of John C. Higgins.)

Redirect Examination

By Mr. Oppenheimer:

Q. Isn't it a fact you purchased a lot more machinery and equipment in addition——

The Court: That has all been covered, Mr. Oppenheimer. Are you through with him now?

Mr. Oppenheimer: I am through, yes.

The Court: I will sit longer if necessary. [89]

Mr. Oppenheimer: We have one more witness whose testimony will be cumulative. I don't know how the Court feels about it, if the Court wants to hear this by another witness that I can call.

The Court: The Government has its case to put on. We will resume at 10:00 in the morning.

(Thereupon an adjournment was taken until 10:00 o'clock a.m., Wednesday, May 16, [90] 1951.)

Wednesday, May 16, 1951—10:00 o'Clock A.M.

Mr. Oppenheimer: If the Court please, we were going to call one more short witness, Mr. Denny Harris, but his testimony would be cumulative and we have decided not to take up the time of the Court on cumulative matters, so the plaintiff now rests.

Mr. Oehmann: We move for judgment at this time, your Honor, on the ground that not only does the plaintiff's proof fail to show that this was a debt which became worthless in 1948, but it affirma-

tively shows that these advances were in the nature of an investment, deductible if at all under the capital loss provisions of the statute.

The Court: Decision will be reserved.

Defendant's Testimony

CHARLES E. KIMBERLEY

was thereupon produced as a witness on behalf of Defendant and, being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Oehmann:

Q. State your full name, please?

A. Charles E. Kimberley.

Q. Are you attached to the Bureau of Internal Revenue? [91]

A. As an Internal Revenue Agent, yes.

Q. Here in Portland? A. Yes, sir.

Q. How long have you been with the Bureau?

A. About twenty-eight years.

Q. Did you participate in the investigation of this case? A. I did.

Q. To what extent?

A. I made an examination of the returns for 1946, 1947 and 1948 of W. J. Jones & Son, Inc.

Q. You are familiar with the 1948 return which claimed a bad debt deduction of \$134,555.21?

A. Yes, sir.

Q. And which reflected a total net operating loss of \$138,379.48?

(Testimony of Charles E. Kimberley.)

A. I don't recall the exact amount of the net operating loss, but I believe there was a net operating loss.

Q. In your investigation and reports made in connection with the case, did you recommend the disallowance of the claim for bad debt deduction of \$134,555.21? A. Yes.

Q. Did you also make an adjustment which consisted of reducing the taxpayer's taxable income for the accrued interest the taxpayer had reported?

A. Yes. The interest which had been accrued on the books of the taxpayer for 1946, after the notes were taken over, that is, [92] by W. J. Jones & Son, Inc.—after they had taken over these notes—amounted to about \$2300 which they had included in income in the return for 1946.

Q. Was there also accrued interest included in the return for 1947?

A. Yes, about \$7,300 for 1947.

Q. How about 1948?

A. And \$7,300 for 1948 included in income for those years in the returns as filed.

Q. In connection with your disallowance of the bad debt deduction, did you make an adjustment for those income items?

A. Yes. Those interest income items which had been reported as income in the returns for each of those years were eliminated from the income in my report.

Q. As a result of the investigation and of these adjustments and other adjustments which are not

(Testimony of Charles E. Kimberley.)

in issue here, if this bad debt deduction is disallowed what will be the result as to 1946?

A. 1946 would show an overassessment of some \$6,000, I believe, without that bad debt deduction and without those interest items.

Q. What would be the result as to 1947?

A. 1947 would show about a \$1,800 refund or overassessment, rather, because of the interest adjustment for that year.

Q. In other words, if this bad debt deduction is disallowed, there will still be a refund of about \$6,400 for 1946 and about \$1,800 for 1947, based in part upon your deducting these income [93] items?

A. Yes, that is correct. There were a few other minor adjustments, but those were the main ones, I believe.

Mr. Oehmann: I think that is all.

Cross-Examination

By Mr. Oppenheimer:

Q. Maybe you can tell me this: When did you propose the disallowance of this so-called bad debt?

A. That adjustment was made in my report for the year 1948. The exact date of these reports I do not recall.

Q. But it was in 1948?

A. It was in the 1948 report.

Q. And at that time you then suggested an adjustment for the corporation by reason of the accrued interest on which it had paid tax on income by

(Testimony of Charles E. Kimberley.)

virtue of these notes, for the years 1946, 1947 and 1948?

A. The 1946 and 1948 reports, I believe, are one report; they are dated the same.

Q. That may be. In other words, until you made the recommendation to disallow this so-called bad debt that is in litigation here, W. J. Jones & Son, Inc., had reported this accrued interest on the notes that it had acquired from Clayton R. Jones, and the Government was agreeable to accepting that as income of W. J. Jones & Son, Inc.? [94]

A. Well, that interest was included in the returns filed.

Q. Yes. A. Yes.

Q. In other words, you were trying to be consistent in rejecting the bad debt by being good to them, by giving them a refund on account of the accrued interest?

Mr. Oehmann: I object to that as argumentative.

The Court: Frame your question differently.

Q. (By Mr. Oppenheimer): In other words, you could not reject the bad debt in 1948 and at the same time accept income from W. J. Jones & Son, Inc., on accrued interest on the notes in question?

A. I consider the adjustment consistent with other adjustments made in the report.

Mr. Oppenheimer: Just read the question, please.

The Court: No, I understand it.

Mr. Oppenheimer: You understand it? Well, that is all, then.

(Testimony of Charles E. Kimberley.)

Q. Was your recommendation based solely upon the books of W. J. Jones & Son, Inc., for the rejection of this so-called bad debt?

A. It was based on all available information that I was able to obtain in the case.

Q. That is pretty nebulous. I understand you on your direct examination to say you examined the books of W. J. Jones & Son, Inc., and therefore recommended rejection of this particular item. I am now asking you whether or not that recommendation is [95] based solely upon an investigation of the books of W. J. Jones & Son, Inc.?

A. I think there was other outside information that I had in addition to what I obtained from the books of W. J. Jones & Son.

Q. You hesitated somewhat in your answer, because I think you want to be fair about it. Do you have any independent recollection at this time of any information outside of the books of W. J. Jones & Son, Inc.?

A. I think I got some information in connection with the Mina del Refugio, probably.

Q. Your recollection is not very clear on that, is it?

A. I am quite certain I did get some information on Mina del Refugio.

Q. Did you make any record of that information?

A. Yes, I think there is some mention in my report, my Revenue Agent's Report.

Q. I mean other than your comments in your report.

(Testimony of Charles E. Kimberley.)

A. Well, other than as stated in my report, I do not think there will be any record unless it would be in my working papers possibly, or somewhere. I put the essential information that I obtained in my report.

The Court: Is the report in evidence?

Mr. Oehmann: Not yet, your Honor.

The Court: Are you going to put it in?

Mr. Oehmann: I want to ask permission for him to refresh [96] his recollection from it.

The Court: All right.

Q. (By Mr. Oppenheimer): Did you find anything on the books of W. J. Jones & Son, Inc., the corporation, that would indicate that these notes were anything other than debts?

A. I inspected the notes at the time I was there.

Mr. Oppenheimer: I don't think you heard the question.

(Question read.)

A. No, I don't believe there was anything in the books of W. J. Jones & Son that would indicate anything.

Mr. Oppenheimer: I think that is all.

Redirect Examination

By Mr. Oehmann:

Q. Did you discuss the case with Mr. Higgins, who was here yesterday?

A. Yes. I talked to Mr. Higgins about the Mina del Refugio corporation.

(Testimony of Charles E. Kimberley.)

Q. Did you talk to Mr. Smith, the secretary of the plaintiff corporation?

A. Yes, I talked to Mr. Smith. He was at the office of the company and I talked to him while I was there.

Q. As a part of your investigation?

A. Yes.

Q. In connection with this case? [97]

A. Yes.

Q. Did you prepare the report, or do you have in your files the report which you prepared for 1946 and 1948?

A. Yes. I prepared a Revenue Agent's report for 1946 and 1948, dated January, 1950.

Q. Would it refresh your recollection if you could read that report as to whom you talked to and what information you developed, other than from what was in the books?

A. I have the report here. Yes, I could refer to it.

Mr. Oehmann: Do you object to it?

Mr. Oppenheimer: Is this an exhibit?

Mr. Kinsey: Is that an exhibit, Mr. Oehmann?

Mr. Oehmann: I ask that the witness be permitted to refresh his recollection from this report, in view of his statement on cross-examination, brought out by counsel, that this was hazy.

The Court: There will be no difficulty about it. It will be granted. Besides, I want to see the report. I want it put in evidence.

Q. (By Mr. Oehmann): Will you consult your

(Testimony of Charles E. Kimberley.)

report and see whether you discussed this matter or whether you did anything but look at the books?

A. Yes. I have some information in the report about the—the report contains an explanation on Page 8 stating the reasons that the \$134,555.21 deduction in 1948, the 1948 return, was not allowed in the report. On Page 8 there is an explanation as to [98] why the deduction was not allowed.

Q. Do you remember that you talked to Mr. Smith and Mr. Higgins?

A. I recall talking to them.

Mr. Oehmann: I think that is all. I want to offer this report at this time.

Mr. Oppenheimer: No further questions.

Mr. Oehmann: Does your Honor want this report?

The Court: Yes.

Q. (By Mr. Oehmann): Do you have a copy there?

A. This is a manuscript report from the office. Have you a copy of that, or do you want to use the manuscript?

Mr. Oehmann: I will have the copy marked with the next exhibit number, if that is satisfactory.

The Court: Yes. I would like to read it now.

(Copy of Internal Revenue Agent's Report, 1948, produced by the witness, was thereupon marked Defendant's Exhibit No. 80.)

The Court: I believe that is all, Mr. Kimberley.

(Witness excused.)

Mr. Oehmann: The Government rests, your Honor.

(Defendant's testimony closed.)

The Court: Do you want to put in any rebuttal?

Mr. Oppenheimer: No, your Honor, there will be no rebuttal. [99]

The Court: Have you seen this report which has just been admitted in evidence?

Mr. Oppenheimer: No. We have never seen it, your Honor.

The Court: It is addressed to the taxpayer, W. J. Jones & Son, Inc., 617 Board of Trade Building, Portland 4, Oregon, written from Seattle 1, Washington.

Mr. Oppenheimer: Then it must be in evidence.

The Court: It starts out with "Gentlemen: I enclose a copy of the report of the examination of your income tax returns for the years 1946-1948"—

Mr. Oppenheimer: I think part of this must be in evidence, your Honor.

The Court: Suppose you check that.

Mr. Oehmann: That includes, of course, the confidential part of the Agent's report which is never sent to the taxpayer. It is the report from which he refreshed his recollection.

The Court: Before you close your case, we had better recess and give you an opportunity to read it over and then see if you want to offer any rebuttal in respect to this exhibit. I would not feel right unless that came into the case.

(Recess.) [100]

CHARLES E. KIMBERLEY

having been previously duly sworn, resumed the stand and further testified as follows:

Further Cross-Examination

By Mr. Oppenheimer:

Q. Mr. Kimberley, what has been referred to as your report, Exhibit 80, has been offered in evidence. I have looked at it rather hurriedly.

I will ask you to tell the Court whether or not you took into consideration in making up your report, the fact that there was assigned to the Mina del Refugio corporation mining rights which had been acquired in the name of D. E. Harris under the trust agreement, which is Exhibit 55, and which were finally assigned to the Mexican corporation, as indicated by Exhibit 56?

A. I don't believe I knew at the time about that.

Mr. Oppenheimer: I think that is all. Thank you.

(Witness excused.)

The Court: Is there any rebuttal?

Mr. Oppenheimer: No, your Honor, no rebuttal.

(Oral argument of counsel.) [101]

Reporter's Certificate

I, Ira G. Holcomb, an Official Reporter of the above-entitled Court, do hereby certify that on May 15 and 16, 1951, I reported in shorthand the proceedings had in the above-entitled matters, that I

thereafter caused my said shorthand notes to be reduced to typewriting under my direction, and that the foregoing transcript, consisting of pages numbered 1 to 101, both inclusive, constitutes a full, true and accurate transcript of said proceedings so taken by me in shorthand on said dates, as aforesaid, and of the whole thereof.

Dated this 29th day of May, 1951.

/s/ IRA G. HOLCOMB,
Official Reporter.

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 6

Form 843

Treasury Department

Internal Revenue Service

Claim

To Be Filed With the Collector Where Assessment
Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse.

- ☐ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

Collector's Stamp (Date received) : Blank.

State of Oregon,
County of Multnomah—ss.

Name of taxpayer or purchaser of stamps: W. J.
Jones & Son, Inc.

Business address: 817 Board of Trade Bldg.,
Portland, Oregon.

Residence:

The deponent, being duly sworn according to law,
deposes and says that this statement is made on
behalf of the taxpayer named, and that the facts
given below are true and complete:

1. District in which return (if any) was filed:
Oregon.

2. Period (if for tax reported on annual basis,
prepare separate form for each taxable year) from
January 1, 1946, to December 31, 1946.

3. Character of assessment or tax: Income taxes.

4. Amount of assessment, \$12,190.32; dates of
payment 1947.

5. Date stamps were purchased from the Gov-
ernment:

6. Amount to be refunded: \$12,190.32.

7. Amount to be abated (not applicable to in-
come, gift, or estate taxes):

8. The time within which this claim may be
legally filed expires, under Section 322 of I.R.C.
on March 15, 1952.

The deponent verily believes that this claim should be allowed for the following reasons:

1. Oregon excise tax of \$1,021.66 plus interest of \$71.52, a total of \$1,093.18, representing excise tax on 1946 income, was paid in 1948, and under the accrual method of accounting is deductible from 1946 income for Federal Income tax.

2. There is a net operating loss deduction attributable to the carry-back of a net operating loss sustained in 1948 that totally absorbs 1946 income thereby reducing it to zero. (See attached.)

/s/ W. J. JONES & SON, INC.,

By

Subscribed and sworn to before me this day of November, 1949.

.....,

(Signature of officer
administering oath.)

W. J. Jones & Son, Inc.
Portland, Oregon

Claim for Refund	Calendar Year 1946
Net operating loss shown on 1948 Corporation Income tax return	\$138,379.48
Less: Contributions deducted on return not allowable under limitation of Sec. 23(q), I. R. C.	446.00
	<hr/>
Net operating loss shown on return, as adjusted	\$137,933.48
Less: Adjustments required by Sec. 122(d), I. R. C.	—
	<hr/>
Statutory net operating loss for 1948	<u><u>\$137,933.48</u></u>

Carry-back of 1948 net operating loss to 1946.....	\$137,933.48	
Reduction under Sec. 122(c) I. R. C.		
Net income for 1946 disclosed by return	\$37,811.93	
Less: Additional Oregon Excise Tax for year 1946, paid in 1948, de- ductible in 1946 under accrual method of accounting	1,093.18	
	<u>\$36,718.75</u>	
Adjustments under Sec. 122(d) I. R. C.	—	
Net income adjusted	\$36,718.75	
Less: Normal tax in- come shown by re- turn	\$37,811.93	
Less: Additional Ore- gon Excise Tax (above)	1,093.18	36,718.75
	<u> </u>	<u> </u>
Excess of net income adjusted over normal tax net income		—
		<u> </u>
Net operating loss deduction applicable to 1946		\$137,933.48
Less: 1946 net income adjusted.....	\$36,718.75	
Plus: Contributions not deductible under the limitation of Sec. 23 (q) I. R. C., after net operating loss deduction	1,135.00	37,853.75
	<u> </u>	<u> </u>
Net operating loss carry-back to 1947.....		<u><u>\$100,079.73</u></u>
Net income shown on return	\$37,811.93	
Less: Technical adjustment for addi- tional 1946 Oregon Excise Tax.....	1,093.18	
	<u> </u>	
Net income shown on return, as adjusted	\$36,718.75	
Net operating loss deduction	137,933.48	
	<u> </u>	
Net income adjusted	—	
	<u> </u>	
Tax liability shown on return	\$12,190.32	
Tax liability, as adjusted	—	
	<u> </u>	
Overassessment	\$12,190.32	
	<u> </u>	

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 7

Form 843

Treasury Department

Internal Revenue Service

Claim

To Be Filed With the Collector Where Assessment
Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse.

- ☐ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

Collector's Stamp (Date received): Blank.

State of Oregon,
County of Multnomah—ss.

Name of taxpayer or purchaser of stamps: W. J. Jones & Son, Inc.

Business address: 817 Board of Trade Bldg.,
Portland, Oregon.

Residence:

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed:
Oregon.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from January 1, 1947, to December 31, 1947.

3. Character of assessment or tax: Income taxes.

4. Amount of assessment, \$154,791.75; dates of payment 1948.

5. Date stamps were purchased from the Government:

6. Amount to be refunded: \$38,030.29.

7. Amount to be abated (not applicable to income, gift, or estate taxes):

8. The time within which this claim may be legally filed expires, under Section 322 of I.R.C. on March 15, 1950.

The deponent verily believes that this claim should be allowed for the following reasons:

1. There is a net operating loss deduction in 1947, attributable to the carry-back of a net operating loss sustained in 1948 to 1946, and the carry-forward from 1946 of the amount of the net operating loss deduction not absorbed by 1946 net income to 1947. (See attached.)

/s/ J. W. JONES & SON, INC.,

By

Subscribed and sworn to before me this day of November, 1949.

.....,

(Signature of officer
administering oath.)

W. J. Jones & Son, Inc.
Portland, Oregon

Claim for Refund	Calendar Year 1947
Net operating loss shown on 1948 Corporation Income tax return	\$138,379.48
Less: Contributions deducted on return not allowable under limitations of Sec. 23(q) I. R. C.	446.00
	<hr/>
Net operating loss shown on return, as adjusted	\$173,933.48
Less: Adjustments required by Sec. 122(d) I. R. C.	—
	<hr/>
Statutory net operating loss for 1948.....	\$137,933.48
	<hr/>
Carry-back of 1948 net operating loss of 1946	\$137,933.48
Less: 1946 net income adjusted	37,853.75
	<hr/>
Net operating loss deduction available to carry-back to 1947	\$100,079.73
Reduction under Sec. 122(d) I. R. C.:	
Net income for 1947 disclosed by return	\$407,346.72
Adjustments under Sec. 122(d) I. R. C.	—
	<hr/>
Net income adjusted	\$407,346.72
Less: Normal tax net income.....	407,346.72
	<hr/>
Excess of net income adjusted over normal tax net income	—
	<hr/>
Net operating loss deduction applicable to 1947.....	\$100,079.73
	<hr/>
Normal tax net income shown by return	\$407,346.72
Less: Net operating loss deduction	100,079.73
	<hr/>
Normal tax net income adjusted	\$307,266.99
	<hr/>
Normal tax, as adjusted	\$ 73,744.08
Surtax, as adjusted	43,017.38
	<hr/>
Tax liability as adjusted	\$116,761.46
Tax liability shown on return	154,791.75
	<hr/>
Decrease	\$ 38,030.29
	<hr/>

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 8

Form 843

Treasury Department

Internal Revenue Service

Claim

To Be Filed With the Collector Where Assessment
Was Made or Tax Paid

The Collector will indicate in the block below the
kind of claim filed, and fill in the certificate on the
reverse.

- ☐ Refund of Taxes Illegally, Erroneously, or
Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused,
or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not applicable to
estate, gift, or income taxes).

Collector's Stamp (Date received): Blank.

State of Oregon,

County of Multnomah—ss.

Name of taxpayer or purchaser of stamps: W. J.
Jones & Son, Inc.

Business address: 817 Board of Trade Bldg.,
Portland, Oregon.

Residence:

The deponent, being duly sworn according to law,
deposes and says that this statement is made on
behalf of the taxpayer named, and that the facts
given below are true and complete:

1. District in which return (if any) was filed: Oregon.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from January 1, 1944, to December 31, 1944.

3. Character of assessment or tax: Excess Profits Tax.

4. Amount of assessment, \$49,871.47; dates of payment 1945.

5. Date stamps were purchased from the Government:

6. Amount to be refunded: \$30,865.50.

7. Amount to be abated (not applicable to income, gift, or estate taxes) :.....

8. The time within which this claim may be legally filed expires, under Section 322(b) of I.R.C. on March 15, 1952.

The deponent verily believes that this claim should be allowed for the following reasons:

The taxpayer reported on its Corporation Income Tax return for the year 1946, a net income of \$37,811.93. The net income for the year 1946, was totally absorbed by a net operating loss deduction resulting from a net operating loss sustained for the year 1948. The 1946 net income as adjusted for the net operating loss deduction is zero and the taxpayer has available an unused excess profits credit of \$36,100.00 as computed by use of the in-

come credit method (per RAR for 1944, dated January 22, 1948), which may be carried back from 1946 to 1944, under provision of Section 122 of the Revenue Act of 1945. The application of the unused excess profits credit adjustment against the 1944 excess profits net income results in the reduction of income subject to excess profits tax and the overpayment of excess profits tax for 1944, in the amount of \$30,865.50. (See attached.)

/s/ W. J. JONES & SON, INC.,

By

Subscribed and sworn to before me this day of November, 1949.

.....,

(Signature of officer
administering oath.)

W. J. Jones & Son, Inc.
Portland, Oregon

Claim for Refund Calendar Year 1944

Computation of tax—1944

Declared value excess profits tax:

Computation as shown by RAR:

Net income for declared value excess

profits tax computation\$ 89,106.26

Less: 10% of \$750,000.00 value of

capital stock 75,000.00

Net income subject to declared value

excess profits tax\$ 14,106.26

Declared value excess profits tax

\$ 931.01

Computation as adjusted—no change

931.01

Difference

—

 Computation of tax—1944 (continued)

Income tax:

Computation as shown by RAR:

Net income for declared value excess
 profits tax\$ 89,106.26
 Add: Net long-term capital gain 309.62

 \$ 89,415.88

Less: Declared value excess profits
 tax 931.01

 Net income\$ 88,484.87

Less: Net long-term
 capital gain\$ 309.62

Income subject to ex-
 cess profits tax 42,075.25 42,384.87

 Balance subject to normal and surtax..\$ 46,100.00

Normal tax\$ 10,791.00

Surtax 7,142.00

 Partial tax\$ 17,933.00

25% of net long-term capital gain 77.41

 Tax liability shown by RAR\$ 18,010.41

Computation as adjusted:

Net income\$ 88,484.87

Less: Net long-term
 capital gain\$ 309.62

Income subject to excess
 profits tax 5,975.25 6,284.87

 Balance subject to normal and surtax..\$ 82,200.00

Normal tax (24%)\$ 19,728.00

Surtax (16%) 13,152.00

 Partial tax\$ 32,880.00

25% of net long-term capital gain 77.41

 Tax liability as adjusted\$ 32,957.41

 Deficiency in normal and surtax by reason of un-
 used excess profits credit carry-back from 1946....\$ 14,947.00

Excess Profits Tax:**Computation as shown by RAR:**

Excess profits net income	\$ 88,175.25
Less: Specific exemption....	\$10,000.00
Excess profits credit.....	36,100.00
Unused excess profits credit adjustment	— 46,100.00
Adjusted excess profits net income	\$42,075.25
95% of adjusted excess profits net income	\$39,971.49
Less: Sec. 784 credit	3,997.15
Tax liability shown by RAR	<u>\$35,974.34</u>

Computation as adjusted:

Excess profits net income	\$ 88,175.25
Less: Specific exemption....	\$10,000.00
Excess profits credits.....	36,100.00
Unused excess profits credit adjustment (carry- back from 1946)	36,100.00 82,200.00
Adjusted excess profits net income.....	\$ 5,975.25
95% of adjusted excess profits net income	\$ 5,676.49
Less: Sec. 784 credit	567.65
Tax liability as adjusted	<u>\$ 5,108.84</u>

Overassessment claimed by reason of unused excess profits credit carry-back from 1946	<u><u>\$30,865.50</u></u>
--	---------------------------

Unused Excess Profits Credit

1946 Normal tax net income disclosed by return	\$37,811.93
Less: Net operating loss deduction resulting from a net operating loss carry-back from 1948 (see schedule supra)	\$37,811.93
Normal tax net income as adjusted	<u>—</u>
Excess profits credit determined by the income credit method (as accepted by RAR dated January 22, 1948, for the years 1944-1945)....	\$36,100.00
Excess profits net income—1946	<u>—</u>
Unused excess profits credit—carry-back of 1944.....	<u><u>\$36,100.00</u></u>

1944	Net income, 1944, as disclosed by RAR	\$88,484.87
	Less: Excess of net long-term capital gain	309.62
		<u>\$88,175.25</u>
	Less: Income subject to excess profits tax as adjusted	5,975.25
		<u><u>\$82,200.00</u></u>
	Excess profits net income, 1944, as disclosed by RAR	\$88,175.25
	Less: Specific exemption	\$10,000.00
	Excess profits credit, per RAR....	36,100.00
	Unused excess profits credit (1946 carry-back)	36,100.00
		<u>82,200.00</u>
	Adjusted excess profits net income as adjusted	<u><u>\$ 5,975.25</u></u>

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 9

Form 1205

Treasury Department
Internal Revenue Service
Seattle 1, Washington

Office of
Internal Revenue Agent in Charge
Seattle Division

March 10, 1950.

W. J. Jones & Son, Inc.,
817 Board of Trade Building,
Portland 4, Oregon.

Gentlemen:

I enclose a copy of the report of the examination of your income tax returns for the years 1946, 1948, in connection with your claim for a refund of \$12,190.32. After consideration by this office, the

Plaintiff's Pre-Trial Exhibit No. 9—(Cont.)

following adjustment of your tax liability appears to be warranted, for the reasons stated in the report:

Years: 1946, 1948. (See attached report for details.)

If You Agree to this adjustment, the enclosed form of acceptance should be executed and forwarded to this office promptly, in order that a certificate of overassessment may be issued without unnecessary delay.

If You Do Not Agree to the proposed adjustment, you may file a protest, executed in triplicate under oath, with this office within 30 days from the date of this letter, stating the grounds for your exceptions. Any protest so filed will have careful consideration, and, if you so request, an opportunity for a hearing in this office will be granted you. This office will be pleased to answer any questions which may occur to you in your examination of the enclosed report.

Should you fail to file with this office within the 30-day period mentioned either an acceptance of the adjustment on the enclosed form or a written protest, a recommendation will be made to the Commissioner of Internal Revenue that a certificate of overassessment be issued in the amount stated above.

Your prompt acknowledgment of the receipt of

Plaintiff's Pre-Trial Exhibit No. 9—(Cont.)
this letter and related papers upon the enclosed
form will be much appreciated.

Respectfully,

/s/ A. R. STOCKTON,
Internal Revenue Agent
in Charge.

Enclosures:

Report of examination.

Form of acceptance.

Form of acknowledgment.

AGE:ebp

Form 1292

Treasury Department

Internal Revenue Service

Instructions as to the Preparation of Protests
Against Findings of Revenue Agent's Reports

The protest and any additional statement of facts
must be submitted to this office, executed in tripli-
cate under the oath of the taxpayer (in the case of
a corporation, the oath of a duly constituted officer)
and contain the following information:

(a) The name and address of the taxpayer (in
the case of an individual the residence, and in the
case of a corporation, the principal office or place
of business);

(b) In the case of a corporation, the name of
the State of incorporation;

(c) The designation by date and symbol of the

Plaintiff's Pre-Trial Exhibit No. 9—(Cont.)

letter advising of the proposed adjustments in tax liability with respect to which the protest is made;

(d) The designation of the year or years involved and a statement of the amount of tax in dispute for each year;

(e) An itemized schedule of the findings to which the taxpayer takes exception;

(f) A statement of the grounds upon which the taxpayer relies in connection with each exception; (See quotation on reverse side from Conference and Practice Requirements, Bureau of Internal Revenue, revised February, 1942);

(g) In case the taxpayer desires a hearing, a statement to that effect;

(h) In case the protest is prepared or filed by an attorney or agent, it shall have thereon a statement signed by such attorney or agent showing whether or not he prepared it and whether or not the attorney or agent knows of his own knowledge that the facts therein are true; and

(i) In case the taxpayer is represented by an attorney or agent it is essential that such representative be admitted to practice before the United States Treasury Department and be provided with a power of attorney, signed by the taxpayer, authorizing him to act for the taxpayer. Powers of attorney must be furnished in duplicate with one additional copy for each taxable year in excess of one.

(j) Attention of representatives is called to the necessity of filing with this office a "Statement

Plaintiff's Pre-Trial Exhibit No. 9—(Cont.)
Relative to Fees'' as required by Section 2(y)
Treasury Department Circular No. 230, revised.

Conference and Practice Requirements
Bureau of Internal Revenue
Revised February, 1942

Evidence Required to Substantiate Facts Alleged
in Conferences

No reduction in taxes proposed nor increases in allowance of claims shall be made unless the evidence upon which such action is taken is submitted in writing and in verified form. All evidence except that of a supplementary or incidental character shall be submitted over the sworn signature of the taxpayer.

The sworn statement of facts must be submitted at least 5 days before the conference date except as hereinafter provided, and must meet all the issues raised by the Bureau which the taxpayer desires to contest. If the sworn statement of facts is not submitted at least 5 days before the conference, then it must be accompanied by a sworn statement setting out specifically the reasons for not having complied with the 5-day rule. Nothing herein shall preclude the taxpayer from submitting additional or supporting evidence within a reasonable time after the conference.

Plaintiff's Pre-Trial Exhibit No. 9—(Cont.)

Preliminary Statement

The overassessment was principally caused by the allowance of a net operating loss deduction.

Findings were explained to Harold F. Smith, Secretary. Agreement was not secured.

Consideration has been given in this report to a claim for refund filed Nov. 4, 1949, in amount of \$12,190.32, for the year 1946. This claim has been allowed in part as explained in the body of this report.

Table of Contents

Schedule 1	Adjustments to Net Income	1946
Schedule 2	Computation of Tax	
Schedule 3	Computation of Unused Excess Profits Credit	
Schedule 4	Adjustments to Net Income	1948
Exhibit A	Balance Sheets	
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Exhibit C	Analysis of Surplus	1948
Exhibit D	Reconciliation of Income	1946
Exhibit E	Reconciliation of Income	1948
Exhibit F	Adjustment of Fixed Assets	
Exhibit G	Reserve for Depreciation	

Schedule No. 1

Year ended: 12/31/46

Adjustments to Net Income

Net income as disclosed by return	\$37,811.93
As corrected	24,852.31
Net adjustment as computed below	12,595.62
Unallowable deductions and additional income:	
(a) Depreciation	\$ 24.49
Total	24.49

Nontaxable income and additional deductions:

(b) 1946 Oregon excise	1,021.66
(c) Property tax refund	119.70
(d) Accrued interest	2,300.22
(e) Operating loss deduction	9,542.53
Total	12,984.11
Net adjustment as above	12,959.62

Plaintiff's Pre-Trial Exhibit No. 9—(Cont.)

Schedule No. 1-A—(Continued)

Year: 1946

Explanation of Items

(a) \$24.49—A book error, over depreciating stevedoring equipment by this amount in 1946, was corrected on the books in 1947. The item was not reported as income in the 1947 return.

(b) \$1,021.66—1946 Oregon Excise tax paid in 1948 is allowed as an accrual. The item was not previously deducted.

(c) \$119.70—To reverse an adjustment made on the return increasing book income by this amount—See Exhibit "D" herein. The refund was credited to book P & L, and should not again have been added.

(d) \$2,300.22—This item represents interest accrued as receivable from Mina Del Refugio, S. A., a Mexican corporation. It is eliminated from income for reason as explained in Schedule 4-A (f) herein.

(e) Operating net loss for 1948, as per Schedule No. 4

herein	\$9,542.53
Net operating loss deduction for 1946	9,542.53

Schedule No. 2

Year: 12/31/46

Computation of Tax
Normal Tax Computation

Net income, Schedule 1	\$24,852.31
Normal-tax net income	24,852.31
Normal tax. If normal-tax net income is:	
Not over \$5,000; tax at 15%	750.00
Over \$5,000 but not over \$20,000 ;	
\$750 plus 17% of excess over \$5,000	2,550.00
Over \$20,000 but not over \$25,000 ;	
\$3,300 plus 19% of excess over \$20,000	921.94

Surtax Computation

Surtax. If surtax net income is:	
Not over \$25,000; tax at 6%	1,491.14
Income tax liability	5,713.08*
Balance	5,713.08
Income tax assessed	12,190.32
Overassessment in income tax	6,477.24

*Note: The alternative tax method results in exactly the same amount of tax in this case.

Plaintiff's Pre-Trial Exhibit No. 9—(Cont.)

Schedule No. 3

Year ended: 12/31/46

Computation of Unused Excess Profits Credit

Normal tax net income, before net operating loss deduction	\$ 34,394.84
Less: Net long-term capital gain 1946	(1,250.00)
Excess profits net income, before net operating loss deduction	33,144.84
Net operating loss deduction from Schedule No. 1	\$ 9,542.53
Adjustment under Sec. 711(a) (1) (J) I.R.C.:	
Add: Net long-term capital gain 1946.....	(1,250.00)
Net operating loss deduction for excess profits tax purposes	8,292.53
Excess profits net income (same as Sch. No. 1)	24,852.31
Excess profits credit 1946:—	
Corrected net aggregate base period net income per Schedule 5 of 1941 report dated 7/31/43 (same applies for 1946)	\$124,758.37
Less: Base period net income for 1936, the smallest of the base period	(7,702.08)
Total of the other 3 years	117,056.29
Average— $\frac{1}{3}$	39,018.76
75% of \$39,018.76=1936 base period net income under provisions Sec. 713(e) I. R. C.	29,264.07
Add: Other 3 base period years, as above	117,056.29
Total	146,320.36
Average base period net income— $\frac{1}{4}$	36,580.09
Excess Profits Credit 1946:	
95% of \$36,580.09, or	34,751.09
Excess profits net income, as above	24,852.31
Unused excess profits credit 1946	9,898.78

Plaintiff's Pre-Trial Exhibit No. 9—(Cont.)
Schedule No. 4

Year ended: 12/31/48

Adjustments to Net Income

Net loss as disclosed by return	\$(138,379.48)
As corrected, loss	(9,542.53)
Net adjustment as computed below	128,836.95
Unallowable deductions and additional income:	
(a) Yacht depreciation	\$ 215.64
(b) Yacht expense	997.46
(c) Deduction as bad debt	134,555.21
(d) Contributions deducted	446.00
Total	\$136,214.31
Nontaxable income and additional deductions:	
(e) Interest on 1946 Oregon Inc. tax.....	71.52
(f) Accrued interest	7,305.84
Total	7,377.36
Net adjustment as above	128,836.95

Schedule No. 4-A

Year: 1948

Explanation of Items

(a) Yacht depreciation written off in 1948 on books	\$1,293.84
Allowed $\frac{1}{3}$ as per conference settlement prior year.....	431.28
Claimed	646.92
Difference	215.64
(b) Yacht expenses per books	5,984.77
Allowed $\frac{1}{3}$ as per conference settlement prior year.....	1,994.92
Claimed	2,992.38
Difference	997.46

(c) From time to time over the period Nov. 1944 to Dec. 1946, Clayton R. Jones, who with his immediate family owns the capital stock of W. J. Jones & Son, Inc., advanced money to Mina Del Refugio, S. A., a Mexican corporation, and took notes, each note payable to Clayton R. Jones, 2 years from date, interest 6%. These notes, of which there are about 32 in number, were endorsed by Clayton R. Jones to W. J. Jones & Son, Inc., without recourse, and Clayton R. Jones' account was credited \$121,763.74, the face value of the notes, plus \$4,654.57 for accrued interest. This occurred in the latter part of 1946, one transfer on Aug. 31, 1946 and one Dec. 31, 1946. Jones & Son, Inc. accrued and reported interest income from these notes as follows:

1946—\$2,300.22; 1947—\$7,305.84; 1948—\$7,305.84. This made a total due from Mina Del Refugio of \$143,330.21, on which no pay-

Plaintiff's Pre-Trial Exhibit No. 9—(Cont.)

ment had been received. The Directors, at a meeting on Dec. 27, 1948, voted to abandon all real property and mining claims, and made arrangements to dispose of the mining equipment and supplies. It was estimated that there would be recovered on the above notes and interest, the sum of about \$8,775.00, and the taxpayer wrote off the balance, or \$134,555.21 as a worthless debt in 1948.

(c) Mina Del Refugio, S. A., has an authorized capital of 5000 shares, par value one peso each, or about 20c. This authorized capital was all issued for the sum of \$1,000.00. Clayton R. Jones acquired and paid cash for 2,156 shares on this basis. This \$1,000.00 of capital was wholly inadequate to conduct the gold mining operation, and the remainder of the capital, for which notes were taken, was in reality risk investment having the incidents of stock. In *Talbot Mills v. Commissioner*, 326 U.S. 521, the Supreme Court said:

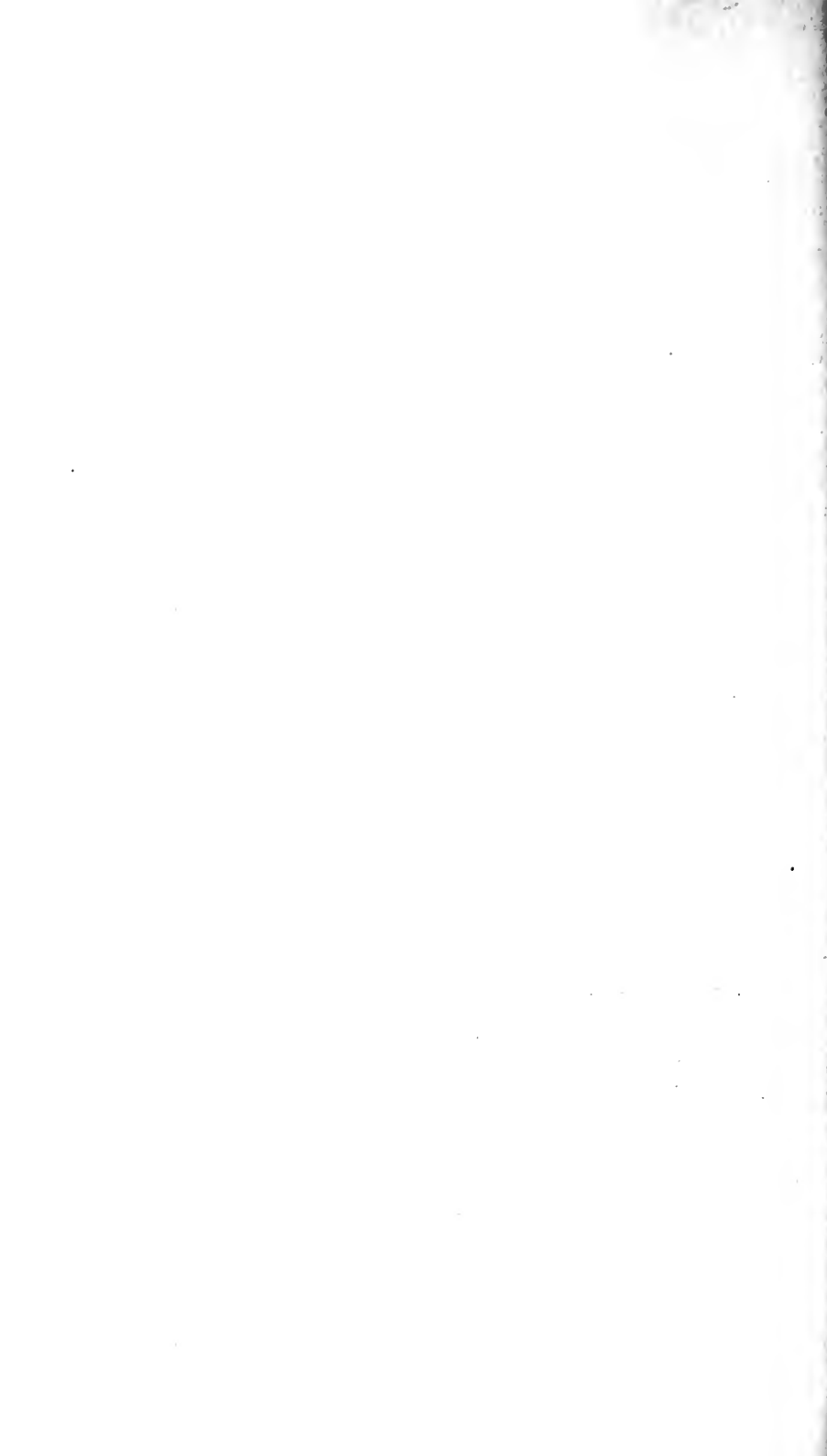
“There is no one characteristic * * * which can be said to be decisive in the determination of whether the obligations are risk investments in the corporations or debts. So called stock certificates may be authorized by corporations which are really debts and promises to pay may be executed which have incidents of stock. * * *”

It is held that the advances were contributions to the risk capital of this corporation, the nature of whose business is always hazardous, and that any ensuing worthlessness would not constitute a bad debt as claimed, but would have the status of a capital loss for income tax purposes. In this case, actual final liquidation had not been completed at Dec. 31, 1948, and there was not a closed transaction, or an allowable capital loss in that year.

(d) \$446.00 Contributions deducted on the return filed are not allowable because there was a net loss for 1948, and contributions may not exceed 5% of net income otherwise determined.

(e) \$71.52—Interest paid in 1948 on 1946 Oregon Excise Tax is an allowable deduction in the year paid. The deduction was not claimed in 1948.

(f) \$7,305.84—This item represents interest accrued as receivable from Mina Del Refugio, S. A., a Mexican corporation. See explanation under (c) above. It is there held that the investment has the incidents of capital investment in this corporation, and income therefrom would constitute dividends, of which none have been declared or paid.



Name of Taxpayer J. Jones & Son, Inc.Date of Report January 27, 1950, 19Examining Officer C. E. Kimberley

Index:

STATEMENT OF TOTAL TAX LIABILITY

YEAR	LIABILITY		PREVIOUSLY ASSESSED*		ADJUSTMENTS PROPOSED IN THIS REPORT			
	Tax	Penalty	Tax	Penalty	TAX		PENALTY	
					Deficiency	Overassessment	Deficiency	Overassessment
INCOME TAX								
6	5,713.08		12,190.32			6,477.24		
8	none		none					
TOTAL								

TOTAL								

TOTAL								

*Summary of Adjustments of Assessments Year 19.....

	INCOME TAX			
Originally assessed.....	\$.....	\$.....	\$.....	\$.....
Deficiency assessed, 19.....,				
Overassessment scheduled, 19.....,				
TOTAL PREVIOUS ASSESSMENTS				

Year 19.....

Originally assessed.....	\$.....	\$.....	\$.....	\$.....
Deficiency assessed, 19.....,				
Overassessment scheduled, 19.....,				
TOTAL PREVIOUS ASSESSMENTS				



Plaintiff's Pre-Trial Exhibit No. 9—(Cont.)

EXHIBIT A-1

Years: 1946, 1947, 1948

Explanation of Items

(a) and (c) To reclassify these items and set up in separate accounts.

(b) Accrued interest receivable on books is adjusted as explained in Schedule 4-A (f).

(d) To reclassify this item, as property of C. R. Jones.

(e) Fixed assets are adjusted as explained in Exhibit F.

(f) Taxes capitalized in prior report, on property purchased.

(g) (h) Items charged off on books, but capitalized prior report.

(i) To accrue 1946 Oregon Excise tax.

(j) To eliminate prepaid property tax.

(k) Reserve for depreciation is adjusted as explained in Exhibit G.

(l) To set up liability resulting from 1944 and 1945 renegotiation; paid in 1947.

(m) Estimated amount to be recovered from Mina Del Refugio, S. A. on investment in that corporation. This is but an estimate and has been eliminated, to be replaced by actual amounts as and when forthcoming.

EXHIBIT B

Year ended: 12/31/46

Analysis of Surplus and Reconciliation of Amended Surplus
With Amended Taxable Net Income

Item	Per Books	Amended
Surplus beginning of period	347,711.92	358,144.02
Add:		
Income per books and corrected tax- able net income	30,497.84	24,852.31
Nontaxable income for period:		
Net operating loss deduction	378,209.76	9,542.53 392,538.86
Deduct		
Dividend (dates):		
1/31/46 cash	7,500.00	7,500.00
Income taxes 1945 paid	105,854.91(1)	75,152.31(1)

Plaintiff's Pre-Trial Exhibit No. 9—(Cont.)

Item	Per Books	Amended
Unallowable deductions:		
Life insurance		\$1,175.73
Political contributions		300.00
Club memberships.....		1,029.40
$\frac{2}{3}$ of yacht expense....		1,517.30
Other charges to surplus during period:		
1942 & 1943 Fed. Inc. tax deficiency.....	2,603.98	2,603.98
	115,958.89	89,278.72
Surplus end of period	262,250.87	303,260.14
(1) \$30,702.60, difference between books and amended represents 1945 tax credit under Sec. 3806(b).		

EXHIBIT C

Year ended: 12/31/48

Analysis of Surplus and Reconciliation of Amended Surplus
With Amended Taxable Net Income

Item	Per Books	Amended
Surplus beginning of period	\$436,839.27	\$478,888.94
Add:		
Loss per books and corrected (146,761.45)	290,077.82	(9,542.53)
		469,346.41
Deduct:		
Unallowable deductions:		
Yacht depreciation....		862.56
Yacht expense.....		3,989.85
Life insurance		2,098.88
Club dues.....		1,425.60
Political contribution		125.00
Contributions deducted on return....		446.00
		8,947.89
Surplus end of period	290,077.82	460,398.52

Plaintiff's Pre-Trial Exhibit No. 9—(Cont.)

EXHIBIT D

Year ended: 12/31/46

Reconciliation of Income Per Books
With Income Per Return

Net income per books	\$30,497.84
Additions to Income:	
Life insurance	\$1,175.73
Refund of property tax credited book P & L....	119.70
Political contributions	300.00
Club memberships	1,029.40
2/3 of yacht expense	1,517.30
1945 Oregon Excise Tax paid	7,776.17
1944 Oregon Excise Tax paid	304.01
Total additions	12,222.31
Total	\$42,720.15
Deductions from Income:	
1946 property tax paid.....	\$3,466.36
Charged book P & L	3,391.49* 74.87
Depreciation cost of yacht restored to books	4,833.35
Credit to P. & L. Eliminated	
*This is exclusive of \$119.70 refund referred to above.	
Total deductions	\$ 4,908.22
Net income per return of taxpayer	\$37,811.93

EXHIBIT E

Year ended: 12/31/48

Reconciliation of Income Per Books
With Income Per Return

Net income per books	(\$146,761.45)
Additions to Income:	
1/2 yacht expense	\$2,992.39
1/2 yacht depreciation	646.92
Life insurance	2,098.88
Club dues	1,425.60
Political contribution	125.00
1946 Oregon Excise Tax	1,021.66
Interest on 1946 Oregon Excise Tax	71.52
Total additions	8,381.97
Total	(138,379.48)
Net income per return of taxpayer (loss)	(138,379.48)

Plaintiff's Pre-Trial Exhibit No. 9—(Cont.)

EXHIBIT F

Adjustment of Fixed Assets Per Balance Sheet

Adjustment crediting fixed assets 12/31/45—	
per 1945 report	\$88,772.99
Less: 1936 Ford truck, burned, previously eliminated	
in 1943 R.A.R.	(1,119.84)
1937 Cad. sold, previously eliminated in 1942 R.A.R.....	(1,970.70)
12/31/46 Credit adjustment	85,682.45
12/31/47 Credit adjustment	85,682.45
Less: 1932 Elwell lift truck previously eliminated in	
R.A.R.	(4,253.21)
12/31/48 credit adjustment	81,429.24

EXHIBIT G

Reserve For Depreciation—Amended

	Debit	Credit	Balance
12/31/45 Balance—			
per Prior Report		\$68,352.60	\$68,352.60
1946 Depreciation per return.....		10,355.90	
1946 Depreciation on auto			
charged C. R. Jones.....		95.55	
1946 Fordson tractor traded-in.....	870.63		77,933.42
1946 Error in depreciation steve.			
Eq. 1946 on books in 1947.....		(24.49)	77,908.93
1947 Depreciation per return		13,783.86	
Dwelling sold	571.43		
1941 Ford Pickup truck			
(sold Aug. '45)	131.25		
1940 Chev. sedan sold	828.92		90,161.19
1948 Depreciation per return		15,921.32	
Depreciation on yacht (1½)....		646.92	
Depreciation on Nash sold	560.34		
Depreciation on Ditto Mach.			
sold	63.60		
Depreciation on Yale Lift			
truck	5,339.40		100,766.09
12/31/48 Balance	100,766.09		
	109,131.66	109,131.66	

Plaintiff's Pre-Trial Exhibit No. 9—(Cont.)

Seattle Div.

Form 873

Treasury Department

Internal Revenue Service

Acceptance of Proposed Overassessment

The following overassessment or overassessments
of tax are hereby accepted as correct:

taxable year ended 12/31/46, income tax in
the sum of\$6,477.24
taxable year ended 12/31/48, income tax in
the sum of\$ None
taxable year ended (declared value)
excess-profits tax in the sum of\$.....
taxable year ended excess profits
tax in the sum of\$.....
taxable year ended in the sum of ..\$.....

amount to the total sum of\$6,477.24
as indicated in the statement furnished the under-
signed taxpayer(s), under date of March 10, 1950.

W. J. JONES & SON, INC.,

Taxpayer.

Portland, Oregon.

By

[Seal]

Date.....

Note.—The execution and filing of this acceptance
at the address shown in the accompanying letter

Plaintiff's Pre-Trial Exhibit No. 9—(Cont.)
will expedite the indicated adjustment of your tax liability. This acceptance is not an agreement as provided under Section 3760 of the Internal Revenue Code.

If this acceptance is executed with respect to a year for which a Joint Return of a Husband and Wife was filed, it must be signed by both spouses, except that one spouse may sign as the agent for the other.

Where the taxpayer is a corporation, the agreement shall be signed with the corporate name, followed by the signature and title of such officer or officers of the corporation as are empowered to sign for the corporation, in addition to which the seal of the corporation must be affixed.

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 10

Form 1205

Treasury Department
Internal Revenue Service
Seattle 1, Washington

Office of
Internal Revenue Agent in Charge
Seattle Division

March 10, 1950.

W. J. Jones & Son, Inc.,
817 Board of Trade Building,
Portland 4, Oregon.

Gentlemen:

I enclose a copy of the report of the examination of your income tax returns for the year 1947, in

connection with your claim for a refund of \$38,030.29. After consideration by this office, the following adjustment of your tax liability appears to be warranted, for the reasons stated in the report:

Year	Overassessment
1947	\$1,830.37

If You Agree to this adjustment, the enclosed form of acceptance should be executed and forwarded to this office promptly, in order that a certificate of overassessment may be issued without unnecessary delay.

If You Do Not Agree to the proposed adjustment, you may file a protest, executed in triplicate under oath, with this office, within 30 days from the date of this letter, stating the grounds for your exceptions. Any protest so filed will have careful consideration, and, if you so request, an opportunity for a hearing in this office will be granted you. This office will be pleased to answer any questions which may occur to you in your examination of the enclosed report.

Should you fail to file with this office within the 30-day period mentioned either an acceptance of the adjustment on the enclosed form or a written protest, a recommendation will be made to the

Commissioner of Internal Revenue that a certificate of overassessment be issued in the amount stated above.

Your prompt acknowledgment of the receipt of this letter and related papers upon the enclosed form will be much appreciated.

Respectfully.

/s/ A. R. STOCKTON,
Internal Revenue Agent
in Charge.

Enclosures:

Report of examination.

Form of acceptance.

Form of acknowledgment.

AGE:ebp

Instructions as to the Preparation of Protests
Against Findings of Revenue Agents' Reports

[See Page 186 to 188 of this printed record.]

Form 986-T
TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
(Revised Feb. 1942)

Name of Taxpayer J. Jones & Son, Inc.

Date of Report January 27, 1950, 19

Index:

Examining Officer W. E. Kimberley

STATEMENT OF TOTAL TAX LIABILITY

YEAR	LIABILITY		PREVIOUSLY ASSESSED*		ADJUSTMENTS PROPOSED IN THIS REPORT			
	Tax	Penalty	Tax	Penalty	TAX		PENALTY	
					Deficiency	Overassessment	Deficiency	Overassessment
INCOME TAX								
1947	152,361.38		154,791.75			1,30.37		
TOTAL								

TOTAL								

TOTAL								

*Summary of Adjustments of Assessments Year 19

	INCOME TAX			
Originally assessed	\$.....	\$.....	\$.....	\$.....
Deficiency assessed, 19				
Overassessment scheduled, 19				
NET PREVIOUS ASSESSMENTS				

Year 19

Originally assessed	\$.....	\$.....	\$.....	\$.....
Deficiency assessed, 19				
Overassessment scheduled, 19				
NET PREVIOUS ASSESSMENTS				



Preliminary Statement

The overassessment was principally caused by elimination of item which was accrued on books as interest receivable. See further explanation in Sch. 1-A (d).

Findings were explained to Harold F. Smith, Sec. Agreement was not secured.

Consideration has been given in this report to a claim for refund, filed Nov. 4, 1949, for the year 1947, in amount of \$38,030.29. This claim is for the allowance of a net operating loss deduction. As determined herein, and in report covering 1946 and 1948 of even date, there is no net operating loss deduction for the year 1947.

Schedule No. 1

Year ended: 12/31/47

Adjustments to Net Income

Net income as disclosed by return	\$407,346.72
As corrected	402,529.94
Net adjustment as computed below	4,816.78
Unallowable deductions and additional income:	
(a) Yacht depreciation	\$ 862.56
(b) Yacht expense	1,815.13
Total	\$2,677.69
Nontaxable income and additional deductions:	
(c) Loss on depreciable assets	\$ 188.63
(d) Accrued interest	7,305.84
Total	7,494.47
Net adjustment as above	4,816.78

Schedule No. 1-A

Year: 1947

Explanation of Items

(a) Yacht depreciation written off in 1947 on books....	\$1,293.84
Allowed $\frac{1}{3}$ as per conference settlement prior year..	431.28
Claimed	1,293.84
<hr/>	
Difference	862.56
(b) Yacht expenses per books	4,356.32
Allowed $\frac{1}{3}$ as per conference settlement prior year..	1,452.11
Claimed	3,267.24
<hr/>	
Difference	
(c) Loss on sale of depreciable, as reported in return filed	188.63
Loss claimed as a deduction in return	none
Loss allowable as a deduction	188.63

(d) \$7,305.84—This item represents interest accrued as receivable from Mina Del Refugio, S. A., a Mexican corporation. It is eliminated from income for reason as explained in Schedule 4-A (f) of Report of even date covering the years 1946 and 1948.

Schedule No. 2

Year: 12/31/47

Computation of Tax
Normal Tax Computation

Net income, Schedule 1	\$402,529.94
Normal-tax net income	402,529.94
Normal tax. If normal-tax net income is:	
Over \$50,000; tax at 24%	96,607.19

Surtax Computation

Net income, Schedule 1	402,529.94
Surtax net income	402,529.94
Surtax. If surtax net income is:	
Over \$50,000; tax at 14%	56,354.19
Income tax liability	152,961.38
Balance	152,961.38
Income tax assessed	154,791.75
Overassessment of income tax	1,830.37

EXHIBIT A

Year ended: 12/31/47

**Analysis of Surplus and Reconciliation of Amended Surplus
With Amended Taxable Net Income**

Item	Per Books	Amended
Surplus beginning of period	\$262,250.87	\$303,260.14
Add:		
Income per books and corrected taxable net income	401,570.47	402,529.94
Nontaxable income for period:		
1942 Post war refund rec.		5,114.56
1943 Post war refund rec.		2,075.21
	663,821.34	712,979.85
Deduct:		
Dividends (dates):		
2/31 cash	60,000.00	60,000.00
Income taxes paid		
1946	12,190.32	12,190.32
Income taxes accrued		
1947	154,791.75	154,791.75
Unallowable deductions:		
Life insurance		1,900.87
Club dues		1,341.20
Political contributions		100.00
1/3 yacht expense		2,904.21
1/3 yacht depreciation		862.56
	226,982.07	234,090.91
Surplus end of period	436,839.27	478,888.94

See balance sheets in 1946-1948 report of even date.

EXHIBIT B

Year ended: 12/31/47

Reconciliation of Income Per Books
With Income Per Return

Net income, per books	\$401,570.47
Additions to Income:	
Life insurance	\$1,900.87
Loss	188.63
Club dues	1,341.20
1/4 of yacht expense	1,089.08
Political contributions	100.00
Deferred property tax a/c closed	1,741.28
Renegotiation payments 1944 & 1945	6,629.45
Total additions	12,990.51
Total	414,560.98
Deductions from Income:	
1942 Post war refund Cr. Rec.	\$5,144.56
1943 Post war refund Cr. Rec.	2,075.21
1946 Depreciation error	24.49*
Total deductions	7,214.26
Net income per return of taxpayer	407,346.72

*This is to eliminate 1947 book credit to P & Loss of this amount. Item is taken up in 1946 report.

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 11

Form 1205

Treasury Department
Internal Revenue Service
Seattle 1, Washington

Office of
Internal Revenue Agent in Charge
Seattle Division

March 10, 1950.

W. J. Jones & Son, Inc.,
817 Board of Trade Building,
Portland 4, Oregon.

Gentlemen:

I enclose a copy of the report of the examination of your income tax returns for the year 1944, in connection with your claim for a refund of \$29,-712.19. After consideration by this office, the following adjustment of your tax liability appears to be warranted, for the reasons stated in the report:

Year: 1944. (See attached report for details.)

If You Agree to this adjustment, the enclosed form of acceptance should be executed and forwarded to this office promptly, in order that a certificate of overassessment may be issued without unnecessary delay.

If You Do Not Agree to the proposed adjustment, you may file a protest, executed in triplicate under oath, with this office, within 30 days from the date

Plaintiff's Pre-Trial Exhibit No. 11—(Cont.)
of this letter, stating the grounds for your exceptions. Any protest so filed will have careful consideration, and, if you so request, an opportunity for a hearing in this office will be granted you. This office will be pleased to answer any questions which may occur to you in your examination of the enclosed report.

Should you fail to file with this office within the 30-day period mentioned either an acceptance of the adjustment on the enclosed form or a written protest, a recommendation will be made to the Commissioner of Internal Revenue that a certificate of over-assessment be issued in the amount stated above.

Your prompt acknowledgment of the receipt of this letter and related papers upon the enclosed form will be much appreciated.

Respectfully,

/s/ A. R. STOCKTON,

Internal Revenue Agent in
Charge.

Enclosures:

Report of examination.

Form of acceptance.

Form of acknowledgment.

AGE:ebp

Instructions as to the Preparation of Protests
Against Findings of Revenue Agent's Reports

[See pages 166 to 168 of this printed Record.]

Form 886-T
TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
(Revised Feb. 1942)

Name of Taxpayer J. Jones & Son, Inc.

Date of Report January 27, 1950, 19__

Index:

Examining Officer C. E. Kimberley

STATEMENT OF TOTAL TAX LIABILITY

YEAR	LIABILITY		PREVIOUSLY ASSESSED*		ADJUSTMENTS PROPOSED IN THIS REPORT			
	Tax	Penalty	Tax	Penalty	TAX		PENALTY	
					Deficiency	Overassessment	Deficiency	Overassessment

INCOME TAX

1944	22,476.92		18,010.41		4,466.51			
TOTAL								

DECLARED VALUE EXCESS PROFITS TAX

1944	931.01		931.01		none			
TOTAL								

EXCESS PROFITS TAX

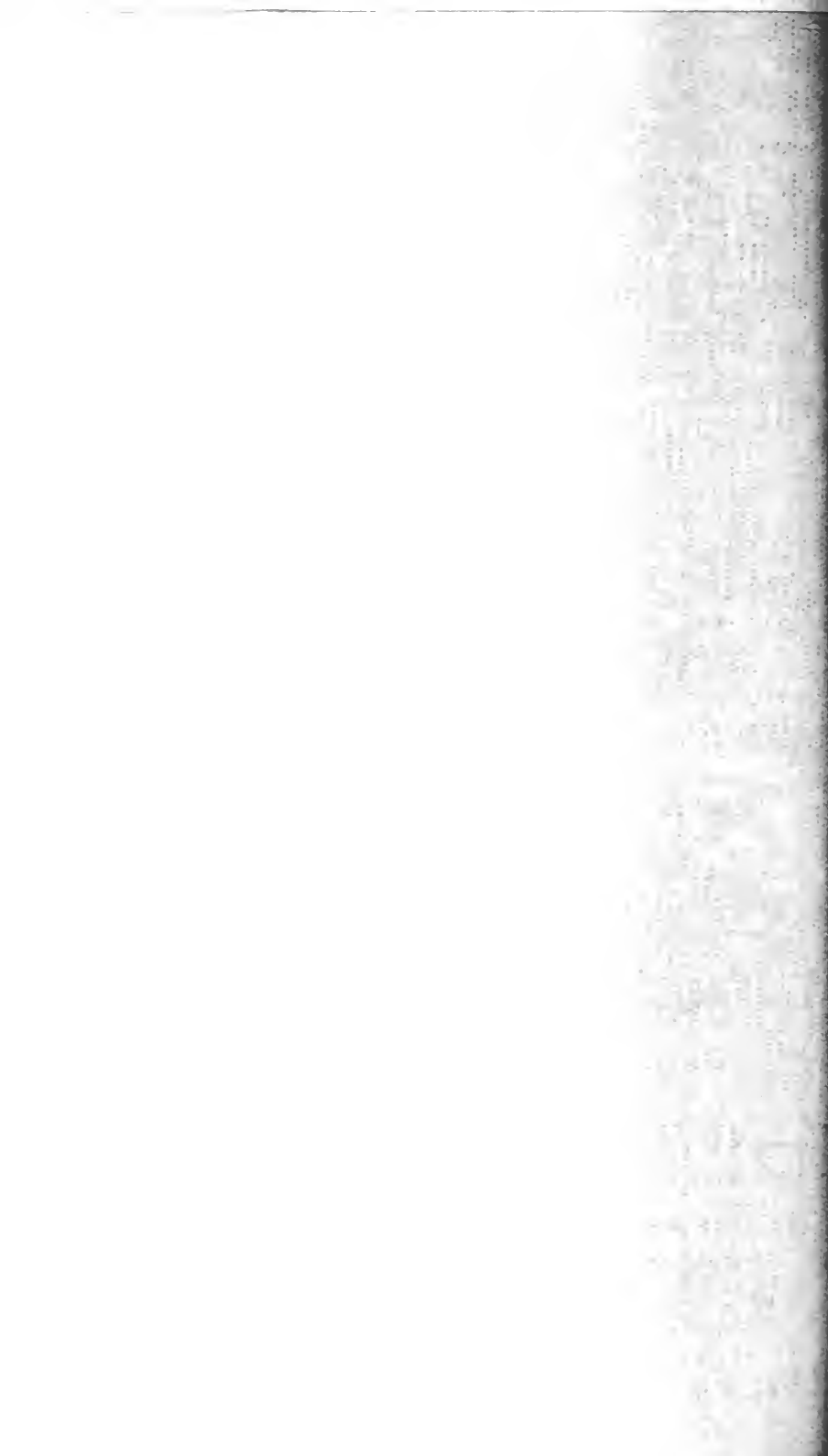
1944	27,510.88		35,974.34			8,463.46		
TOTAL								

*Summary of Adjustments of Assessments Year 1944

	INCOME TAX	D.V.E.P. Tax	E.P. Tax	
Originally assessed	\$ 18,010.41	\$ 1,667.40	\$ 49,871.47	\$
Credit - Sec. 3806(b)(1)	-0-	693.27	8,388.29	
Deficiency assessed, 19__	-0-	-0-	4,987.15	
Credit - Sec. 784 Form 7986	-0-	43.12	521.69	
Overassessment scheduled, 1948	-0-			
NET PREVIOUS ASSESSMENTS	18,010.41	931.01	35,974.34	

Year 19__

Originally assessed	\$	\$	\$	\$
Deficiency assessed, 19__				
Overassessment scheduled, 19__				
NET PREVIOUS ASSESSMENTS				



Plaintiff's Pre-Trial Exhibit No. 11—(Cont.)

Preliminary Statement

The overassessment was caused by the allowance of an unused excess profits credit adjustment.

Findings were explained to Harold F. Smith, Secretary. Agreement was not secured.

Consideration has been given in this report to a claim for refund for the year 1944, dated 11/4/49, in the amount of \$30,865.50. This claim has been allowed in part as explained in the body of this report.

Schedule No. 1

Year ended: 12/31/44

Adjustments to Net Income

Net income as disclosed by report of 1/22/48	\$89,415.88
As corrected	89,415.88
Net adjustment as computed below	none

Schedule No. 2

Year ended: 12/31/44

Computation of Tax

Declared Value Excess Profits Tax Computation

No change in D. V. E. P. Tax liability

Alternative Income Tax Computation

Net income for declared value excess-profits tax computation	\$89,106.26
Add: Excess of net long-term capital gain over short- term capital loss	309.62
Total, Schedule No. 1	89,415.88
Less: Declared value excess profits tax	931.01
Net income	88,484.87
Less: Excess of net long-term capital gain	(309.62)
Less: Adjusted excess profits net income, Schedule 4..	32,176.47
Balance subject to normal and surtax	55,998.78

Plaintiff's Pre-Trial Exhibit No. 11—(Cont.)

Normal Tax Computation

Normal-tax net income	\$55,998.78
Normal-tax (24% of normal-tax net income).....	13,439.71

Surtax Computation

Surtax net income	55,998.78
Surtax (16% of surtax net income)	8,959.80
Partial tax	22,399.51
Add: 25% of capital gain	77.41
Balance of normal tax and surtax	22,476.92
Income tax assessed	18,010.41
Deficiency of income tax	4,466.51

Schedule No. 3

Year ended: 12/31/44

Adjustments to Excess-Profits Net Income for the
Taxable Year Computed Under Income Credit Method

Excess-profits net income for the taxable year computed under income credit method as disclosed by report of 1/22/48	\$88,175.25
As corrected	88,175.25
Net adjustment	none

Plaintiff's Pre-Trial Exhibit No. 11—(Cont.)

Schedule No. 4

Year ended : 12/31/44

Excess Profits Tax Computation

1. Excess profits net income, Schedule 3..	\$88,175.25
2. Less: Specific exemption	\$10,000.00
3. Excess profits credit per original report	36,100.00
4. Unused excess profits credit adjustment, Schedule 5	9,898.78 55,998.78
5. Adjusted excess profits net income.....	32,176.47
6. 95% of Item 5	30,567.65
7. Surtax net income (computed without regard to the credit provided by section 26(e)), Schedule 2..	88,484.87
8. 80% of Item 7	70,787.90
9. Income tax (other than section 102), Schedule 2	22,476.92
10. Excess of Item 8 over Item 9	48,310.98
11. Item 6, or Item 10, whichever is lesser..	30,567.65
12. Less: Credit, Sec. 784(a)	3,056.77
13. Correct excess profits tax liability.....	27,510.88
14. Previous assessment	35,974.34
15. Overassessment in excess profits tax....	8,463.46

Schedule No. 5

Year: 1944

Unused E. P. Credit Adjustment

Unused E. P. Credit per Sch. No. 3 of 1946 Report of even date	\$9,898.78
Unused E. P. Credit Adjustment	9,898.78

Plaintiff's Pre-Trial Exhibit No. 9—(Cont.)
PLAINTIFF'S PRE-TRIAL EXHIBIT No. 12

U. S. Treasury Department
Internal Revenue Service
Seattle 1, Wash.

Office of
Internal Revenue Agent in Charge
Seattle Division

August 17, 1950.

Mr. Clayton R. Jones,
817 Board of Trade Building,
Portland 4, Oregon.

Dear Mr. Jones:

Reference is made to the report of examination covering your income tax liability for the year 1946 which was forwarded to you on June 9, 1949.

As a result of additional information secured subsequent to the time that the report was prepared, a revision in the proposed deficiency has been made. There is accordingly forwarded herewith a copy of the revised statement showing the change in tax liability and a recomputation of the deficiency. If you are not in agreement with the indicated change, an amendment to your protest dated July 5, 1949, should be filed with this office.

Very truly yours,

/s/ E. HALLOWELL,

Acting Internal Revenue
Agent in Charge.

CC—Mr. Kinsey
IGG:mtr

Office of
Internal Revenue Agent In Charge
Seattle Division
Revised Statement

Portland, Oregon
August 14, 1950

Taxpayer: Clayton R. Jones,
817 Board of Trade Building,
Portland, Oregon.

As a result of protest filed and a conference held in connection therewith, the following adjustments are found to be necessary in the income tax liability of the above named individual for the calendar year 1946.

Deficiency in Tax per R.A.R.	Deficiency in Tax as Amended	Difference
\$20,539.97	\$24,386.97	\$3,847.00

Detail of adjustments is shown in the following schedules:

Schedule 1

Year 1946

Net Income

Net income disclosed by revenue agent's report.....	\$95,211.10
Increase: Interest income	4,654.57
Net income amended	<u>\$99,865.67</u>

Explanation

Accrued interest on Mina Del Refugio S. A. notes realized upon sale of such notes in 1946 not included in gross income by taxpayer.

Schedule 2

Computation of Income Tax—Alternative Method
For Calendar Year 1946

Net income, Schedule 1	\$99,865.67
Less: Net long-term capital gains	1,299.75
Ordinary net income	<u>\$98,565.92</u>
Less: Exemptions	500.00
Normal tax and surtax net income	<u>\$98,065.92</u>
Tentative normal tax and surtax	\$65,637.35
Less: 5% of tentative tax	3,281.87
Balance	<u>\$62,355.48</u>
5% of net long-term gain	649.88
Income tax liability	<u>\$63,005.36</u>
Income tax liability disclosed by return..	38,618.39
Deficiency in tax	<u>\$24,386.97</u>

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 46

Translation

United States of Mexico

General Notarial Archives of the State of Sonora

In Charge of

Citizen Armando V. Escalente

Second Certified Copy of the Articles of Incorporation of the Corporation "Mina Del Refugio, Sociedad Anonima," With Capital Stock of Five Thousand Pesos, of Fifty Years Duration, Organized by Messrs. Enrique Torres and Malcom C. Little.

Hermosillo, Sonora, Mexico, October 18, 1950

Translation

On each sheet revenue stamps to the value of 1.20 pesos and the seal of the Notarial Archives of the State of Sonora.

Vol. 12, No. 644.

In the City of Nogales, District of Magdalena, State of Sonora, Mexico, on the 5th day of January, 1932, before me, Atty. Arsenio Espinosa, Notary Public No. 6, and the witnesses hereto, Messrs. Alfredo H. Hernandez and Cristobal Espinosa, both of legal age, married, employees, residents of this place and competent to testify, appeared Messrs. Enrique Torres and Malcolm C. Little, Jr., both of legal age, married, the first a Mexican citizen, an accountant and a resident of Nogales, Sonora, and

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

the second an American citizen, an attorney, a resident of Nogales, Arizona, United States of America, and temporarily in this city. Said parties, who are personally known to the undersigned Notary, to which he certifies and likewise that in my opinion they are legally competent to contract and obligate themselves, declared: that they hereby organize a sociedad anonima (limited liability corporation), as a private enterprise, in accordance with article 166 of the Commercial Code, subject to the following clauses:

First: The name of the company is "Mina Del Refugio, Sociedad Anonima."

Second: The principal domicile of the company is the city of Nogales, State of Sonora, Republic of Mexico. The Board of Directors is expressly authorized to establish branches and agencies and to designate conventional domiciles in any other part of the Republic of Mexico, or in foreign countries, and in such case, to hold its meetings at such branches or agencies.

Third: The purpose of the company is: a) The acquisition, exploitation and alienation of mining claims and concessions. b) The acquisition, exploitation and alienation of industrial plants and installations, buildings and lands necessary or convenient to the foregoing purpose. c) The organization of other companies and the participation therein in consideration for the transfer of properties by any legal title, whether such companies

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

be partnerships or stock companies. d) Any undertaking, civil or mercantile, relating or accessory to the foregoing, and in general the execution of all contracts and the performance of all acts necessary or convenient to the realization by the company of said purposes.

Fourth: The duration of the company is fifty years, to terminate December 31, 1982, the first corporate year to be from the date of these presents to December 31, 1932.

Fifth: The capital of the company is Five Thousand Pesos of Mexican silver (\$5,000.00), fully subscribed as follows: Mr. Enrique Torres subscribes \$4,997.00 pesos and Mr. Malcolm C. Little, Jr., three pesos, which they pay for in cash, Mr. Little obligating himself to transfer one share each to Messrs. Douglas Cather and William J. Mitchell.

Sixth: The capital stock is divided into 5000 shares each of the par value of one peso, which shares shall be represented by certificates comprising one or more shares. Said certificate shall be issued in the name of the owner, or to bearer, as each stockholder may elect, and shall be delivered to the incorporators as subscriptions are paid in proportion to their subscriptions, or to persons by them designated by letter addressed to the President.

Seventh: For the management of the affairs of the company there will be a Board of Directors, consisting of not fewer than three nor more than

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

seven members, who from among their members shall elect a President, a Vice-President, a Secretary and a Treasurer. One person may hold two offices. The Board of Directors shall have the following powers:

a) To carry out all operations, acts and contracts required by the purposes of the company, including the organization of other companies, either partnerships or stock companies; to sell, pledge or otherwise encumber or alienate corporate assets, to buy subject to term payments and to enter into credit operations.

b) To represent the company, or cause it to be represented, in and out of court, with full powers, even those by law requiring a special grant of authority, and to this end to authorize such powers of attorney that it may deem necessary.

c) Freely to name and remove attorneys in fact and officers and employees of the company, and to fix their compensation.

d) To fix the representative and executive powers of the President.

e) All other powers conferred by the laws of the land and by the charter of the company, not expressly reserved to the stockholders.

Eighth: There may be a manager, who will exercise the powers to him hereafter granted by the Board of Directors.

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

Ninth: There also shall be a comisario appointed by the stockholders, who shall exercise the powers by law to him granted, to continue in office one year.

Tenth: The Board shall be appointed at regular annual meetings of stockholders, or sooner, in case of a vacancy by death, resignation or removal, but until appointments are made by the stockholders, the remaining members of the board in meeting assembled, may name a substitute for director or directors temporarily or permanently disqualified.

Eleventh: The reserve fund shall be made up of five per cent of the net profits, up to twenty per cent of the capital stock. The by-laws may provide for one or more additional reserve funds.

Twelfth: Profits shall be distributed annually proportionately to the corporate shares of stock, and losses shall be born in like manner by the stockholders to the amount of the capital stock subscribed and not paid. The Board of Directors may, however, declare dividends before the termination of the corporate year, if they are derived from profits actually realized.

Thirteenth: The incorporators of the company as such do not reserve any participation in the profits.

Fourteenth: The company shall be dissolved prior to the expiration of its term: a) by resolution of the stockholders; b) because of bankruptcy.

Fifteenth: In case of liquidation a general meet-

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

ing of stockholders shall determine, as it may see fit, the rules governing the liquidation, and in the absence of such rules, the rules provided in the Commercial Code for stock companies shall be applied.

When the company enters into liquidation, the powers of the Board of Directors and of the Manager shall terminate, and the liquidator or liquidators shall be subrogated thereto.

Sixteenth: The by-laws of the company shall adopt rules for the calling and holding of meetings of the Board of Directors and of regular and special meetings of stockholders, as to what shall constitute a quorum, a majority, to fix the powers of the officers and, in general, to govern all those matters relating to the conduct and management of the company, its dissolution and liquidation, not provided for in these presents. Therefore, the organizers of the company at this time exhibit to me the by-laws by them approved for insertion herein.

Seventeenth: Every foreigner who in the organization of this company, or at any time subsequent thereto, acquires an interest or participation in the company, shall by such act be considered a Mexican, with respect to such interest or participation, and it shall be understood that he agrees not to invoke the protection of his own government, under penalty, in case he fails in his agreement, of forfeiting such interest or participation to the Mexican Nation. This clause shall be inserted in the stock certificates.

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

Provisional: a) For the present and until the stockholders otherwise decide, the Board of Directors shall consist of the following persons: Enrique Torres, C. Douglas Cather and Malcolm C. Little, Jr., the first as President and Treasurer, the second as Vice-President and the third as Secretary. b) Mr. William J. Mitchell, is named comisario for the first year, and until his successor is elected.

By-Laws
Capital Stock

Article 1: The shares shall be issued in the name of the owner, or to bearer, as the stockholder may elect. Stock certificates representing shares shall be taken from stock books having stubs, they shall be numbered in sequence from one on, shall be signed by the President and Secretary of the company, or by their alternates, and shall comply with the requirements 179 of the Commercial Code. One certificate may represent one or more shares, as the party interested may choose.

Article 2: The ownership, assignment and the modification or transfer of ownership of shares, and all other matters relating thereto, are subject to the provisions of articles 181, 182 and other relevant provisions of the Commercial Code.

Article 3: The company shall recognize as stockholders only the bearers of stock certificates, with respect to registered stock, except in case of court order to the contrary, issued by a competent judge.

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

Article 4: Every stockholder, by the mere fact of so being, submits himself and is submitted to the provisions of the charter and by-laws of the company, and to resolutions legally approved at meetings of stockholders and of the Board of Directors.

Article 5: All shares confer upon their owners the same rights and impose the same obligations in matters relating to the attendance and voting at meetings of stockholders, the participation in profits, the assessment of losses to the amount of the par value of each share subscribed and not paid for, and relating to rights and liabilities recited in the charter, in the by-laws and in the law.

Article 6: On petition of the owner and at his expense stock certificates may be changed for others of different denomination, on condition that the new certificates shall represent the same number of shares as the old certificates given in exchange. The cancellation and issuance of new certificates shall not be made on the stubs of certificates.

Article 7: When because of destruction or loss a petition is filed asking that a certificate be replaced, the President of the Board of Directors shall publish notice of such petition in the Official Paper of the State. If after fifteen days from publication no one objects, a duplicate certificate shall be issued, the cost of the publication and other costs to be paid by the party interested.

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

General Meetings of Stockholders

Article 8: General meetings of stockholders shall be regular and special.

Article 9: The purpose of regular meetings shall be to discuss, approve or modify the trial balance corresponding to corporate year, after receiving the comisario's report; to elect during each corporate year members of the Board of Directors and the comisario and to fix their compensation, in case it is deemed necessary to fix salaries, and to decide other matters appearing in the Order of Business.

Article 10: Regular meetings shall be held annually, at the domicile of the company during the month of January, at the place designated in the notice thereof. This notice shall be published once only in the Official Bulletin of the State of Sonora and, in the absence of such paper, in any other paper of the State at least eight days in advance of the date of the meeting, in the notice stating the time and place of the meeting and the Order of Business.

Article 11: If the Board of Directors does not call a regular meeting when due, the comisario may in its stead do so, and the meeting may be held even after the month of January with the same legal effect.

Article 12: The purpose of special meetings shall be the removal or appointment of one or more members of the Board of Directors and of the Comisario, and any other matters within the powers of a stockholder's meeting.

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

Article 13: The Board of Directors, the comisario or any other officer of the company may call a special meeting of stockholders whenever deemed necessary, observing the formalities required for regular meetings; and the Board of Directors must call a special meeting when so required in writing by one or more stockholders that represent at least twenty-five per cent of the capital stock, on condition that the petition be accompanied by the Order of Business.

Article 14: If the Board of Directors does not approve such petition, or fails to publish notice of the meeting, including therein the full Order of Business presented by the stockholder, or stockholders, any one of them may do so through the Civil Court of First Instance of the domicile of the company.

Article 15: To be admitted to meetings of stockholders it shall be sufficient to present one or more certificates of stock.

Article 16: When stockholders present at a meeting represent all of the capital stock, notice thereof shall not be required, and neither shall notice be required if for any cause the meeting is adjourned to be continued at a different time. In either of said cases, it shall so appear in the minutes of the meeting.

Article 17: The Secretary, before the meeting is installed, shall compute the shares represented and shall make a list of the persons present. This

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

list shall be inserted in the minutes and shall be signed by the Secretary.

Article 18: Stockholders may appear at meetings in person, or by proxy in the form of a general or special power, in the latter case a letter-power signed by the stockholder shall be sufficient.

Article 19: To hold regular or special meetings of stockholders the representation of a majority of the capital stock shall be necessary. In case of Article 206 of the Commercial Code the representation indicated shall not be necessary in response to the first or second call. Meetings may also be held with the stockholders present, regardless of the number of shares represented, even less than one-half of the capital stock, when the meeting did not take place because of lack of a quorum and had to be held pursuant to a second call; the same shall apply in case a general meeting is convened with the required quorum, as provided in the by-laws, and one or more of the stockholders leave before the meeting is over, or the matters before the meeting are not finished and the meeting is adjourned to a different time and place.

Article 20: Once it appears that a quorum is present, the President shall declare the meeting legally convened and shall proceed with the Order of Business, the President presiding.

Article 21: Voting shall be by ballot, unless some one requests that it be by persons.

Article 22: In meetings of stockholders each share shall be computed as one vote.

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

Article 23: At meetings a majority shall consist of one share in excess of one-half of the shares represented.

Article 24: A general meeting of stockholders has full powers to decide all matters pertaining to the affairs of the company, and its decisions shall be obligatory on all stockholders, even those absent or dissenting.

Article 25: The President of the Board shall preside at meetings of stockholders, and, in his absence, the Vice-President, and in the latter's absence the person appointed by the meeting.

Article 26: The Secretary of the Board shall act as Secretary at meetings of stockholders, and in his absence the person designated by the meeting.

Article 27: The Secretary shall prepare minutes of each meeting, and shall prepare a record thereof, which shall contain: a copy of the minutes; a copy of the paper in which notice was published; the proxies presented, or extracts of general powers presented signed by the Secretary, and other documents and petitions presented to the meeting. The minutes shall be signed by all present, and the copy by the Secretary.

Article 28: If for any cause a meeting legally called is not held, a minute thereof shall be made showing such fact and the cause thereof, and a record shall be made as provided in the preceding article.

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

Board of Directors

Article 29: The Board of Directors shall exercise the powers set out in the articles of incorporation. The corporate name shall be used by the person serving as president.

Article 30: Members of the Board of Directors to qualify shall deposit with the treasury of the Company one share of the corporate stock.

Article 31: The directors and officers shall continue in office during the period for which elected, or until their successors are elected.

Article 32: When one or more positions on the Board are vacant, the director or directors remaining shall provisionally appoint a substitute or substitutes, who shall serve until the incumbent returns, or others are elected at the next succeeding meeting of stockholders.

Article 33: Meetings of the Board of Directors shall be regular and special, the first to be held without special call at eleven a.m. on the first Monday of each month at No. 20, Calle Elias, in Nogales, Sonora, or at the time and place designated by the Board. Special meetings shall be held when called by the President or Secretary of the Board, or on petition of any of the directors, by sending special notice by registred mail to the domiciles of the directors, therein stating the hour, date and place of the meeting and the Order of Business. Notice shall not be required when all the directors are present. Meetings of the Board may be held in

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

foreign countries where the Company has established an office, branch or agency.

Article 34: Members of the Board of Directors shall be elected by majority vote at meetings of stockholders. The President, and in his absence the Vice-President, shall preside at meetings of the Board, and, in the absence of both, the member designated by the Board.

Article 35: To hold a meeting of the Board the presence of a majority of its members is necessary; resolutions shall be by majority vote, and in case of a tie, the vote of the presiding officer shall decide.

Article 36: Minutes signed by the President and Secretary shall be prepared of all meetings of the Board. Also, when for any cause a meeting cannot be held, all the members present shall sign the minutes.

Comisario

Article 37: The qualifications of the comisario are the same as those of directors, as set forth in article 30 of the by-laws.

Article 38: In addition to the elected comisario the meeting of stockholders may appoint one or more alternates, when deemed necessary.

The President

Article 39: The President shall have the following powers:

1. To represent the Company in and out of court, and in addition thereto to exercise the powers conferred by law and these by-laws.

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

2. To represent the Company before all political, administrative and judicial authorities, federal, local or municipal, in all matters, even those requiring a special grant of authority, in original actions, their incidents or recourses, including the power to make bids and counter bids, to dismiss suits, settle by compromise or arbitration, to ask and answer interrogatories, disqualify, receive payment and acknowledge signatures and documents.

3. To locate, apply for, purchase or otherwise acquire mining claims and concessions; to manage and lease the properties of the Company; to enter into contracts and perform all civil and mercantile acts required by the ordinary conduct of the business; to execute such public and private documents as may be necessary in the premises; but he cannot execute negotiable instruments, bonds, or obtain loans, or alienate or encumber real property without the authority so to do of the Board of Directors or of the stockholders.

4. To grant general or special judicial powers of attorney, with power of substitution as a whole or in part, and revoke powers, and to execute all kinds of instruments, in exercise of the foregoing powers.

Vice-President

Article 40: The Vice-President shall exercise all the powers of the President in case of the latter's absence or incapacity.

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

Manager

Article 41: The Board of Directors may freely appoint and remove the Manager, who shall have the powers conferred in the articles of incorporation, the Commercial Code and resolutions adopted by the Board of Directors.

Secretary and Treasurer

Article 42: The Secretary and Treasurer of the Company, in addition to the powers conferred by the by-laws, shall have in their charge: the first, the books, stocks certificates and minutes; and the second, the accounting and corporate funds, and both of them shall exercise the powers by law conferred.

Dividends

Article 43: An annual inventory shall be made of the properties and operations of the company.

Article 44: Net profits realized shall be distributed as follows: five per cent shall be applied to the reserve fund, until such fund equals one-fifth of the capital stock; the amounts voted by the stockholders to constitute other funds; and the rest shall be divided, when so decided by the Board of Directors, among the stockholders in proportion to the number of their shares.

Article 45: Notice of the distribution of profits shall be sent to each stockholder. Dividends not

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

collected within five years from the date of the notice shall revert to the company.

Dissolution and Liquidation

Article 46: The dissolution and liquidation of the Company shall be made in the manner provided in the articles of incorporation. During the period of liquidation the stockholders shall retain full powers over the Company, observing in relation to meetings and majorities the provisions of these by-laws.

General Provisions

Article 47: In all cases in which in accordance with the law, the articles of incorporation and these by-laws notice is to be served on a stockholder by publication in the Official Bulletin, publication may be omitted if the stockholder in writing admits knowledge of the notice, or voluntarily complies with or performs the act referred to in the respective resolution.

The incorporators presented to the undersigned notary a permit issued by the department of Foreign Affairs, which is as follows:

“A marginal seal as follows: Executive Federal Power.—Mexico.—United Mexican States.—Secretary of Foreign Affairs.—Diplomatic Department.—No. 2243.—Stamps to the value of twenty pesos duly cancelled.—In the center.—The Chief Clerk of Foreign Affairs Certifies:—That a petition was received from Messrs. Enrique Torres and Malcolm

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

C. Little, Jr., advising that they proposed to organize a sociedad anonima (limited liability corporation), for mining purposes, in accordance with the laws of the land, with legal domicile therein, to be called "Mina Del Refugio, S. A.," and in compliance with the latter portion of article 2 of the Regulations of the Organic Law of Section I of article 27 of the Constitution, they requested that this Secretary grant a permit to include in the articles of incorporation of the Company the following clause, as provided in said article: "Every foreigner who, at the time of its incorporation or any later time, acquires an interest or participation in the company shall be considered by such act to become a Mexican, with respect to said interest or participation, and it shall be understood that he agrees not to invoke the protection of his government, under penalty, in case he fails in his agreement, of forfeiting said interest or participation to the Mexican Nation." The above clause shall be printed or engraved on the stock certificates in addition to the data required by article 179 of the Commercial Code, in compliance with article 4 of said Regulations, to enable foreigners legally to acquire the stock; wherefore this Secretary decided to grant, and does hereby grant, to said persons the necessary authority to include said insertions in the articles of incorporation and in the stock certificates subject to the conditions and restrictions established in articles 1 and 3 of said Organic Law

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

of Fraction I of article 27 of the Constitution, article 7 of said Regulations, Section IV of said article 27 of the Constitution and other relevant legal provisions. This permit must be inserted in full in the articles of incorporation of the Company in compliance with article 3 of said Regulations. On application of the interested parties these presents are issued in Mexico City, October 27, 1931. Signed M. E. Otalera, Chief Clerk. I, the Notary, certify that the foregoing is a true and correct copy of the original, which I have before me and have read and attached to the Appendix of this Book, in a folder bearing the same number as this instrument, under letter "A."

In relation to the payment of income tax the parties declare: Mr. Torres that his tax is paid, and Mr. Little, that he is not subject to such tax.

These presents having been read to the contracting parties, and they understanding the legal value and effect thereof, likewise their obligation to record same, they agreed to the contents thereof and ratified the same in its entirety, and signed in the presence of the Notary and of the witnesses hereto, to all of which I certify:—Signed: Enrique Torres.—Malcolm C. Little, Jr.—Alfredo H. Hernandez.—Cristobal Espinosa.—A. Espinosa.

I authorize these presents the 7th day of January, 1932, and attach a statement of the stamp tax to the respective Appendix and folder, and letter "B,"

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

I certify. Signed: Arsenio Espinosa,—Notarial Seal.

In the margin: Notarial seal and stamps to the value of \$5.50 of national currency, duly cancelled.—In the center: Citizen Chief of the Federal Tax Office, Present.—On the 5th day of the current month documento No. 644, contained on 12 sheets of Book No. 12 of the Protocol of the Notarial Office No. 6, was executed by Messrs. Enrique Torres and Malcolm C. Little, Jr., containing the articles of incorporation of mining company called "Mina Del Refugio, Sociedad Anonima," with a capital stock of \$5,000.00 pesos of Mexican silver, which, in my opinion, is taxable at the rate of one peso for each 1000 pesos or fraction thereof, in accordance with section 54, subsection I of the Schedule of the Stamp Law now in force, which, with the additional tax, amounts to \$5.50. In regard to income tax Mr. Torres declares that his tax has been paid and Mr. Little states that he is not subject thereto.—Nogales, Sonora, January 6, 1932. Signed: Arsenio Espinosa, Notary Public No. 6.

The undersigned Chief of the Federal Tax Office certifies: that on this day there were attached to and cancelled on this memorandum the stamps referred to in the preceding liquidation, made under the responsibility of the notary signing same. Nogales, Sonora, January 7, 1932.—Signed: E. Tamez, Chief of the Federal Tax Office.—An official seal.

Plaintiff's Pre-Trial Exhibit No. 46—(Cont.)

This Second Certified Copy Was Taken From the Original on Application and for the Use of an Interested Party. It is Contained on Nine Sheets, Compared and Corrected, Bearing the Stamps by Law Required, Duly Cancelled. Hermosillo, Sonora, October 18, 1950.—I certify. Signed: Armando V. Escalante, Director of the General Notarial Archives. An official seal.

State of Arizona,
County of Santa Cruz—ss.

Malcolm C. Little, having first been sworn, on oath deposes and says: I am a resident of Nogales, Arizona, an attorney at law, also admitted to practice in the State of Sonora, Mexico; I know the Spanish and English languages; I have made a translation from Spanish to English of the articles of incorporation and by-laws of "Mina Del Refugio, S. A.," a Mexican corporation, and to my best knowledge and belief the foregoing is a true and correct translation thereof.

/s/ M. C. LITTLE.

Sworn to and subscribed before me, a Notary Public in and for said County and State, this 4th day of November, 1950.

/s/ DOLORES W. LOPEZ,
Notary Public.

My commission expires December 5, 1951.

Certificado No. **1**

No. de Acciones 1249

Accionista Enrique
Jones

Fecha Enero 11 de 1932

Recibi

Enrique Jones

162

Certificado No. **2**

No. de Acciones 1249

Accionista Enrique
Jones

Fecha Enero 11 de 1932

Recibi

Enrique Jones

163

Certificado No. **3**

No. de Acciones 1249

Accionista Enrique
Jones

Fecha Enero 11 de 1932

Recibi

Enrique Jones

164

Certificado No. **4**

No. de Acciones 1249

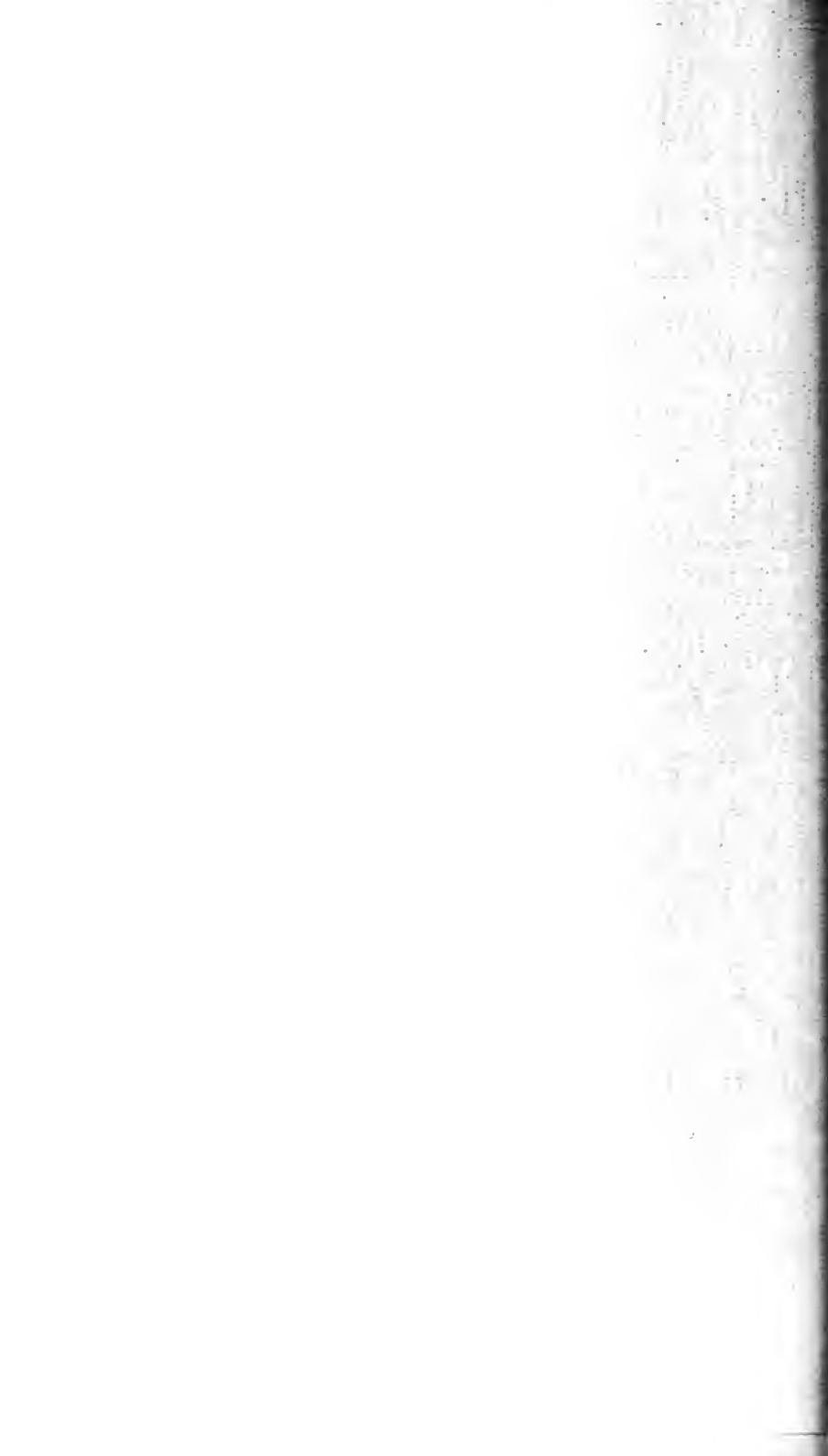
Accionista Enrique
Jones

Fecha Enero 11 de 1932

Recibi

Enrique Jones

165



Certificado No. 5No. de Acciones unaAccionista Enrique
JonesFecha Enero 11 de 1932Recibi Enrique JonesCertificado No. 6No. de Acciones UnaAccionista M. C. Little Jr.Fecha Enero 11 de 1932Recibi Malcolm LittleEnrique JonesMalcolm LittleCertificado No. 7No. de Acciones UnaAccionista M. C. Little Jr.Fecha Enero 11 de 1932Recibi Malcolm LittleMalcolm LittleCertificado No. 8No. de Acciones UnaAccionista M. C. Little Jr.Fecha Enero 11 de 1932Recibi Malcolm LittleMalcolm Little



Certificado No. 9No. de Acciones 974

Accionista _____

Clayton R. JonesFecha Marzo 22 de 1948

Recibi _____

Certificado No. 10No. de Acciones 974

Accionista _____

John C. HigginsFecha Marzo 22 de 1948

Recibi _____

Certificado No. 11No. de Acciones 250

Accionista _____

Walter M. WellsFecha Marzo 22 de 1948

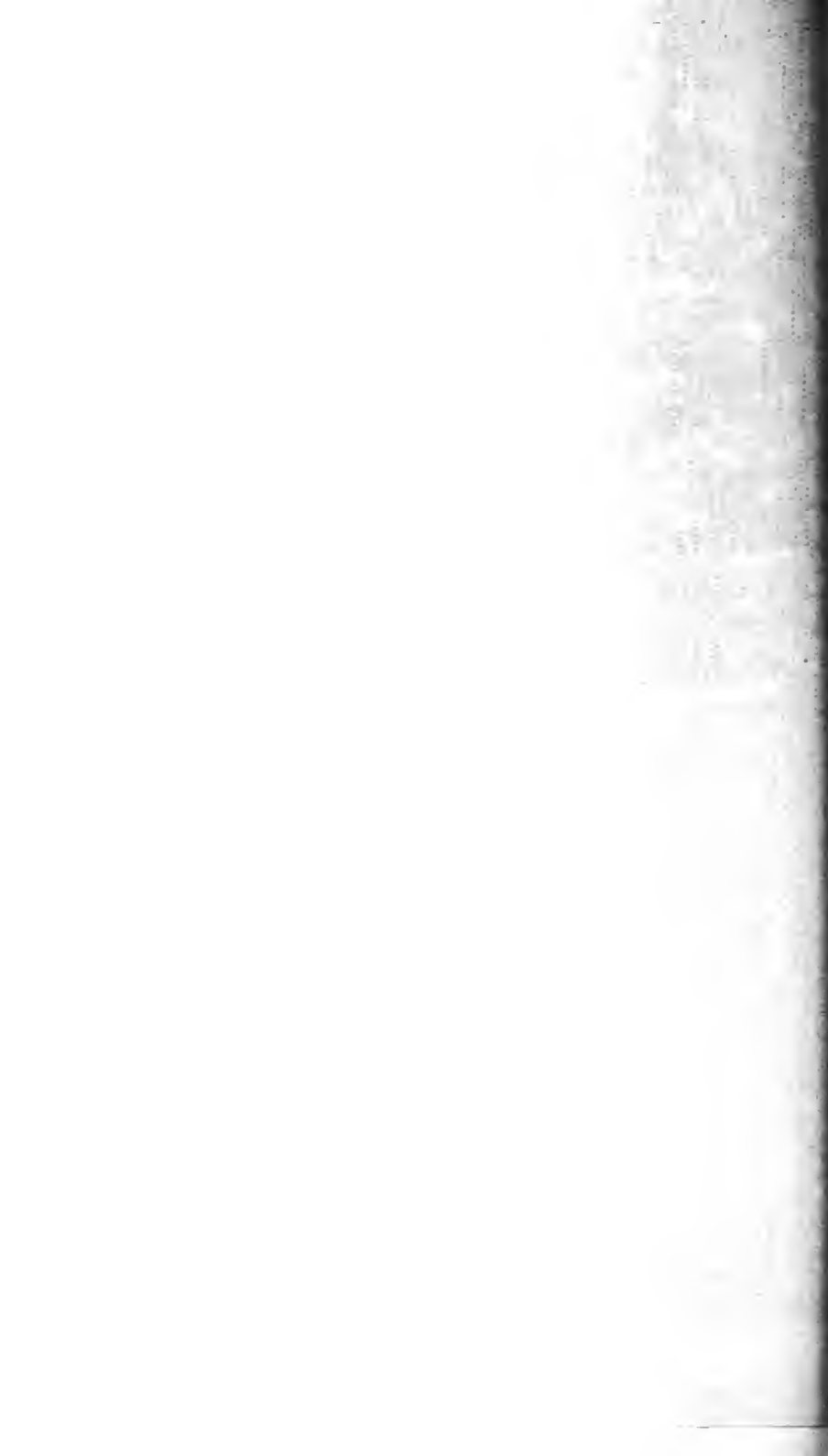
Recibi _____

Certificado No. 12No. de Acciones 250

Accionista _____

Mrs Diana W. ScottFecha Marzo 22 de 1948

Recibi _____



Certificado No. 13No. de Acciones 25

Accionista _____

Mrs Diana W. Scott

Fecha March 22 de 1948

Recibi _____

74 31

Certificado No. 15No. de Acciones 31

Accionista _____

John C. Higgins
Fecha March 22 1948Certificado No. 14No. de Acciones 25

Accionista _____

Mrs Diana W. Scott

Fecha March 22 de 1948

Recibi _____

G. Jones 1180

Certificado No. 16No. de Acciones 1180

Accionista _____

Clayton R Jones
Fecha March 22, '48



Certificado No. 17No. de Acciones 19Accionista Thomson S HarrisFecha March 22, 1948

Recibi _____

Certificado No. 18No. de Acciones 13

Accionista _____

R. F. Harris
Fecha March 22, 1948

Recibi _____

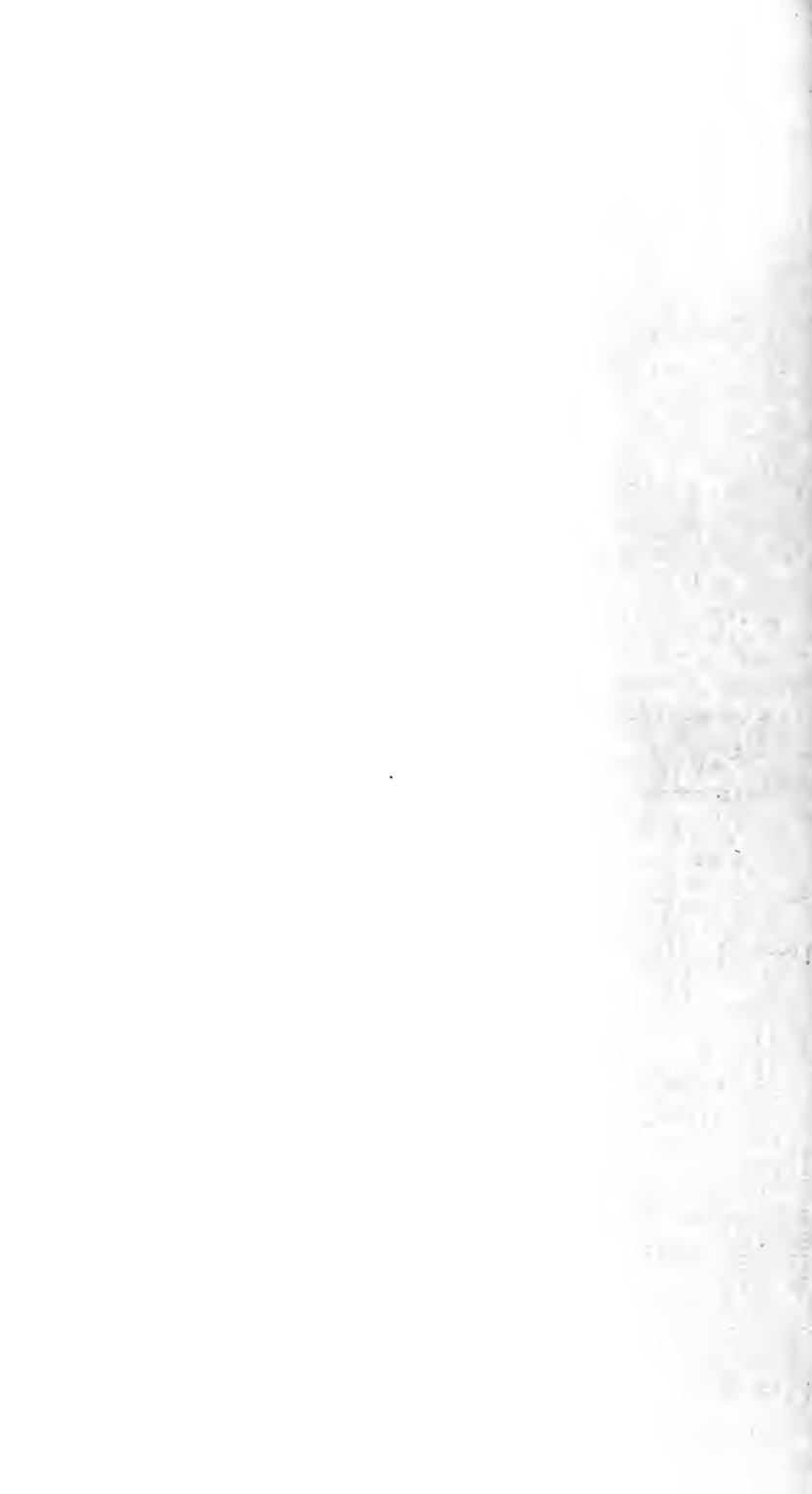
Certificado No. 19No. de Acciones 6

Accionista _____

R. B. Harris

Fecha March 22, 48

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PLAINTIFF'S PRE-TRIAL EXHIBIT No. 51

EXHIBIT 51

Organization Expense

				Account No. 2-2	
Date 1944	Description	Posting Ref.	Charges	Credits	Balance
Aug. 31		CD1	\$5.00		
Sept. 30		CD1	11.68		
Oct. 31		CD1	669.96		
Nov. 30		CR1		\$175.03	
Nov. 30		CD2	22.12		
Dec. 31		CD2	15.54		\$549.27
1945					
Jan. 31		CD3	1,519.50		
Feb. 28		CD3	7.27		
Mar. 31		CD4	4.60		
Apr. 30		CD4	8.05		
May 31		CD5	19.50		
June 30		CD5	126.21		
July 31		CD6	3.00		
Aug. 31		CD6	10.94		
Sept. 30		CD7	3.00		
Oct. 31		CD7	4.00		
Nov. 30		CD8	4.00		
Dec. 31		CD8	4.00		
Dec. 31		J2		89.33	2,174.01
1946					
June 30		CD13	8.82		2,182.83

Exploration and Development Expense

				Account No. 2-1	
Date 1944	Description	Posting Ref.	Charges	Credits	Balance
Aug. 31	Engineering Fees ..	CD1	\$950.00		
Aug. 31	Other Dev. Exp.	CD1	136.41		
Sept. 30	Engineering Fees ..	CD1	300.00		
Sept. 30	Other Dev. Exp.	J1	100.00		
Sept. 30	Other Dev. Exp.	CD1	1,405.94		
Oct. 31	Other Dev. Exp.	CD1	45.60		
Nov. 30	Other Dev. Exp.	CD2	43.31		
Dec. 31	Engineering Fees ..	CD2	750.00		
Dec. 31	Other Dev. Exp.	J1	7,728.08		
Dec. 31	Other Dev. Exp.	CD2	450.24		\$11,909.58

Plaintiff's Pre-Trial Exhibit No. 51—(Cont.)

Date	Description	Posting Ref.	Charges	Credits	Balance
1945					
Jan. 31	Other Dev. Exp.	CD3	\$185.35		
Feb. 28	Other Dev. Exp.	CR1		\$175.03	
Feb. 28	Other Dev. Exp.	CD3	12.81		
Mar. 31	Other Dev. Exp.	CD4	96.75		
Apr. 30	Other Dev. Exp.	CD4	54.35		
May 31	Engineering Fees ..	CD5	925.00		
May 31	Other Dev. Exp.	CD5	499.97		
June 30	Other Dev. Exp.	CD5	797.57		
July 31	Other Dev. Exp.	CR2		161.12	
July 31	Other Dev. Exp.	CD6	948.14		
Aug. 31	Other Dev. Exp.	CD6	16.64		
Sept. 30	Engineering Fees ..	CD7	1,785.00		
Sept. 30	Other Dev. Exp.	CD7	610.38		
Oct. 31	Other Dev. Exp.	CD7	301.34		
Nov. 30	Other Dev. Exp.	CR3		15.08	
Nov. 30	Other Dev. Exp.	CD8	834.26		
Dec. 31	Other Dev. Exp.	CR3		74.52	
Dec. 31	Other Dev. Exp.	CD8	222.04		
Dec. 31	Other Dev. Exp.	J2	89.33		
Dec. 31	Other Dev. Exp.	J2	41,220.16		
Dec. 31	Other Dev. Exp.	J3		883.11	\$59,199.81
1946					
Jan. 31	Other Dev. Exp.	CR3		26.34	
Feb. 28	Other Dev. Exp.	CR3		15.65	
Jan. 31	Other Dev. Exp.	CD9	112.24		
Feb. 28	Other Dev. Exp.	CD9	500.54		
Mar. 31	Other Dev. Exp.	CR4		11.04	
Mar. 31	Engineering Fees ..	CD10	1,450.00		
Mar. 31	Other Dev. Exp.	CD10	937.00		
Apr. 30	Engineering Fees ..	CD11	1,626.50		
Apr. 30	Other Dev. Exp.	CD11	1,061.02		
May 31	Other Dev. Exp.	CD12	266.38		
June 30	Other Dev. Exp.	CD13	163.67		
July 31	Other Dev. Exp.	CD14	156.49		
Aug. 31	Other Dev. Exp.	CD15	117.14		
Sept. 30	Engineering Fees ..	CD16	1,000.00		
Sept. 30	Other Dev. Exp.	CD16	134.35		
Oct. 31	Other Dev. Exp.	CD17	403.43		
Nov. 30	Engineering Fees ..	CD18	1,500.00		
Nov. 30	Other Dev. Exp.	CD18	311.15		
Dec. 31	Other Dev. Exp.	CR6		87.52	
Dec. 31	Other Dev. Exp.	CD19	324.08		
Dec. 31		J4	59,437.36		
Dec. 31		J4		2,973.08	
Dec. 31		J3		1,323.72	124,263.81

Plaintiff's Pre-Trial Exhibit No. 51—(Cont.)

Date	Description	Posting Ref.	Charges	Credits	Balance
1947					
Jan. 31	Engineering Fees ..	CD20	\$475.00		
Jan. 31	Other Dev. Exp.	CD20	427.41		
Feb. 28	Engineering Fees ..	CD21	2,500.00		
Feb. 28	Other Dev. Exp.	CD21	76.34		
July 31		J4		\$475.00	\$127,267.56
Dec. 31		J5		503.48	
Dec. 31		J5		1,718.76	
Dec. 31		J5	16.81		
Dec. 31		J6		4.25	
Dec. 31		J6		70.34	
Dec. 31		J6		90.84	
Dec. 31		J7	2,415.62		127,312.32

Trucks and Tractors

Date	Description	Posting Ref.	Charges	Credits	Balance
1944					
Nov. 30		CD2	\$96.37		\$96.37
1945					
May 31		CD5	250.00		
June 30		CD5	18.12		
July 31		CD6	.70		
Aug. 31		CD6	1,471.76		
Sept. 30		CD7	1,500.00		
Oct. 31		CD7	109.36		
Nov. 30		CD8	8.16		
Dec. 31		J2	228.40		3,682.87
1946					
Jan. 31		CD9	225.46		
Feb. 28		CD9	947.05		
Mar. 31		CD10	15.50		
Apr. 30		CD11	286.34		
May 31		CD12	500.00		
June 30		CD13	2,208.88		
July 31		CR5		\$11.90	
July 31		CD14	791.86		
Aug. 31		CD15	51.20		
Sept. 30		CD16	778.12		
Oct. 31		CD17	163.52		
Nov. 30		CR5		9.15	
Nov. 30		CD18	100.00		
Dec. 31		CD19	35.78		9,765.53
Dec. 31		J5	58.39		
Dec. 31		J5		110.72	
Dec. 31		J7		228.40	9,484.80

Plaintiff's Pre-Trial Exhibit No. 51—(Cont.)

Office Equipment

				Account No. 1-6	
Date	Description	Posting Ref.	Charges	Credits	Balance
1945					
Sept. 30		CD7	\$60.00		
1944					
Dec. 31	In Mexican office..	J1	40.82		
1945					
Dec. 31		J2	255.88		\$356.70
1947					
July 31		J4	134.23		490.93
Dec. 31		J7	4,235.88		4,726.81

Camp

				Account No. 1-2	
Date	Description	Posting Ref.	Charges	Credits	Balance
1945					
Sept. 30		CD7	\$4,020.50		\$4,020.50

Water System

				Account No. 1-2	
Date	Description	Posting Ref.	Charges	Credits	Balance
1945					
Sept. 30		CD7	\$905.13		\$905.13
1947					
Jan. 31		CD20	551.89		
Feb. 28		CD21	1,538.19		2,995.21
Sept. 30		CD27	4,387.12		7,382.33

Mill Building

				Account No. 1-3	
Date	Description	Posting Ref.	Charges	Credits	Balance
1946					
Apr. 30		CD11	\$2,271.76		
May 31		CD12	1,969.93		
July 31		CD14	1,245.00		
Sept. 30		CD16	350.00		
Dec. 31		J3	441.24		\$6,277.93
Dec. 31		J5	503.48		
Dec. 31		J6	70.34		6,851.75

Plaintiff's Pre-Trial Exhibit No. 51—(Cont.)

Mine Equipment

Date	Description	Posting		Account No. 1-4	
		Ref.	Charges	Credits	Balance
1944					
Sept. 30		CD1	\$437.06		
Oct. 31		CD1	4,615.13		
Dec. 31		CD2	1.73		\$5,053.92
1945					
Feb. 28		CD3	167.50		
Mar. 31		CD4	26.77		
Apr. 30		CD4	12.12		
May 31		CD5	1,270.27		
June 30		CD5	9.33		
July 31		CR2		\$1.72	
July 31		CD6	161.10		
Aug. 31		CD6	500.00		
Sept. 30		CD7	4,410.87		
Oct. 31		CD7	25.45		
Nov. 30		CD8	161.50		
Dec. 30		J2	1.35		11,798.46
1946					
Jan. 31		CD9	1.32		
Feb. 28		CD9	727.96		
Mar. 31		CD10	1,645.39		
Apr. 30		CD11	125.97		
May 31		CR4		18.21	
May 31		CD12	10.91		
June 30		CD13	249.45		
July 31		CD12	69.70		
Aug. 31		CD15	20.88		
Sept. 30		CD16	394.23		
Oct. 31		CD17	48.36		
Dec. 31		CD19	65.84		15,140.26
1947					
Jan. 31		CR6		27.05	
Jan. 31		CD20	12.40		
Feb. 28		CR6		1,886.62	
Apr. 30		CD23	2,257.79		
Oct. 31		CD28	1,053.00		16,549.78
Dec. 31		J5		531.50	
Dec. 31		J7	758.06		16,776.34

Plaintiff's Pre-Trial Exhibit No. 51—(Cont.)

Mill Equipment

		Account No. 1-5			
Date	Description	Posting Ref.	Charges	Credits	Balance
1945					
Sept. 30		CD7	\$540.90		\$540.90
1946					
Jan. 31		CD9	1,500.00		
Mar. 31		CD10	5,515.65		
Apr. 30		CD11	2,000.00		
May 31		CD12	10,068.50		
June 30		CD13	3,544.01		
July 31		CR5		\$7.71	
July 31		CD14	13,083.45		
Aug. 31		CD15	2,637.21		
Sept. 30		CD16	3,554.62		
Oct. 31		CD17	1,974.10		
Nov. 30		CD18	1,784.68		
Dec. 31		CD19	1,657.80		
Dec. 31		J3	882.48		48,735.69
1947					
Jan. 31		CD20	1,743.58		
Feb. 28		CD21	465.88		
Mar. 31		CD22	283.25		
July 31		CD25	11.38		
Aug. 31		CD26	113.24		
July 31		J4	475.00		51,828.02
Dec. 31		J5	36.32		
Dec. 31		J5	110.72		
Dec. 31		J7	2,531.92		54,506.98

Advances Clayton R. Jones

		Account No. 5-5			
Date	Description	Posting Ref.	Charges	Credits	Balance
1944					
Aug. 9		J1			\$1,000.00
Aug. 25		J1		4,000.00	
Aug. 31		CR1		1,000.00	
Sept. 30		CR1		3,000.00	
Sept. 30		J1		100.00	
Nov. 30		CR1		5,000.00	
Nov. 30		J1	\$515.50	14,100.00	

Plaintiff's Pre-Trial Exhibit No. 51—(Cont.)

Date	Description	Posting Ref.	Charges	Credits	Balance
1945					
Jan. 31		CR1		\$5,000.00	
Mar. 31		CR1		1,500.00	
Apr. 30		CR1		2,500.00	
May 31		CR2		3,000.00	
June 30		CR2		2,500.00	
July 31		CR2		3,500.00	
Aug. 31		CR2		6,000.00	
Sept. 30		CR2		10,000.00	
Oct. 31		CR2		2,500.00	
Nov. 30		CR3		1,500.00	
Dec. 31		CR3		3,000.00	
Dec. 31		J2	\$2,848.55	55,100.00	
1946					
Jan. 31		CR3		1,000.00	
Feb. 28		CR3		3,500.00	
Mar. 31		CR4		6,000.00	
Mar. 31		CD10	2,000.00		
Apr. 30		CR4		12,000.00	
May 31		CR4		5,000.00	
June 30		CR4		9,000.00	
July 31		CR5		8,000.00	
Aug. 31		CR5		9,500.00	
Sept. 30		CR5		7,000.00	
Oct. 31		CR5		5,000.00	
Nov. 30		CR5		2,000.00	
Dec. 31		CR6		5,000.00	
1947					
Jan. 31		CR6		5,000.00	
Feb. 28		CR6		4,000.00	
Mar. 31		CR6		3,000.00	
Apr. 30		CR7		2,000.00	
May 31		CR7		4,500.00	
July 31		CR7		1,000.00	
Aug. 31		CR7		7,000.00	
Sept. 30		CR8		2,000.00	
Dec. 31		CR8		1,000.00	
Dec. 31		J6	154,123.85		

Plaintiff's Pre-Trial Exhibit No. 51—(Cont.)

Advances John C. Higgins

Account No. 5-5

Date	Description	Posting Ref.	Charges	Credits	Balance
1944					
Aug. 25		J1		\$5,006.50	
Aug. 31		CR1		1,000.00	
Sept. 31		CR1		3,000.00	
Nov. 30		CR1		5,000.00	
Nov. 30		J1	\$515.50	14,006.50	
1945					
Jan. 31		CR1		3,000.00	
Feb. 28		CR1		500.00	
Mar. 31		CR1		2,500.00	
Apr. 30		CR1		2,000.00	
May 31		CR2		4,000.00	
June 30		CR2		4,000.00	
July 31		CR2		1,000.00	
Aug. 31		CR2		7,000.00	
Sept. 30		CR2		10,000.00	
Oct. 31		CR2		2,100.00	
Nov. 30		CR3		2,400.00	
Dec. 31		CR3		2,000.00	
Dec. 31		J2	2,848.56	54,506.50	
1946					
Jan. 31		CR3		5,000.00	
Mar. 31		CR4		6,500.00	
Mar. 31		CD10	2,000.00		
Apr. 30		CR4		7,500.00	
May 31		CR4		12,000.00	
June 30		CR4		6,000.00	
July 31		CR5		9,500.00	
Aug. 31		CR5		8,000.00	
Sept. 30		CR5		5,000.00	
Oct. 31		CR5		5,000.00	
Nov. 30		CR5		5,000.00	
Dec. 31		CR6		4,000.00	
1947					
Jan. 31		CR6		4,000.00	
Feb. 28		CR6		7,000.00	
Apr. 30		CR7		3,500.00	
May 31		CR7		2,500.00	
June 30		CR7		1,500.00	
July 31		CR7		500.00	
Aug. 31		CR7		5,500.00	
Sept. 30		CR8		6,000.00	
Oct. 31		CD28	1,000.00		
Dec. 31		CR8		1,000.00	
Dec. 31		J6	154,130.35		

Plaintiff's Pre-Trial Exhibit No. 51—(Cont.)

Advances D. E. Harris

Account No. 5-5

Date	Description	Posting Ref.	Charges	Credits	Balance
1944					
Sept. 30		CR1		\$3,000.00	
Dec. 31		J6	\$3,000.00		

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 52

June 30th, 1944.

Mr. Clayton R. Jones,
c/o W. J. Jones & Co., Inc.,
Board of Trade Building,
Portland, Oregon.

Dear Mr. Jones:

Subsequent to our conversation on the telephone yesterday, the following is a concise remise of the enterprise that I have in the State of Sonora, Mexico.

For the past several months I have been developing a property comprising approximately 72 acres and the time has come, due to conditions over which I have no control, that I must ask for outside financial help, for the following reasons.

When I first purchased the above-mentioned property, I had at my command the necessary moneys to carry on a program that I had mapped out and for that reason I went into the proposition on a larger scale than I would have had I not believed that I would have been able to carry it through to a successful conclusion. As I mentioned to you on the telephone.

I have approximately 6000 tons of ore definitely blocked that averages throughout \$22.00 a ton of which \$18.00 is in gold and the balance silver. In developing this ore we have reached a depth of approximately 250 feet on a 36 degree incline. On the 250 foot level, I have drifted approximately 135 feet, both ends of the drift in ore and the face of the vein material averages better than 6 ft. All of this development work has been on ore.

There is no doubt in anyone's mind from the geological history of the district but what this ore shoot will continue with depth. To tell you what that continuation in footage will amount to, it would be impossible at this time, but the history of the State of Sonora shows in this formation that 1,000 feet is not anticipating too much.

To give you a geological report would be possible but I am sure that an examination by an engineer, designated by yourself would expedite matters and at the same time satisfy you and your associates much more than I or anyone than I had write a report could do.

I need to put the property in operation, meaning milling, mining, approximately \$30,000.00, provided an engineer would recommend the same amount of development and tonnage to be milled a day that I have anticipated at this time.

The \$30,000.00 would be spent as follows:

I have a cash payment falling due of \$10,000.00. A further payment of \$25,000.00 to be paid out of 10% of the smelter returns. This \$25,000.00 to be paid over a period of four years with no minimum,

monthly or yearly payments, excepting that the property must be worked in a workmanlike manner taking into consideration things which over we would have no control, such as strikes, breakdowns and acts of God, etc.

Mr. Jones, I have been in the mining business a great many years and I say without fear of contradiction, that this property has as great a potentiality as it has ever been my privilege to have been associated with.

In conclusion, I have no partners, no commitments, no financial structure and with the exception that we must operate under a Mexican Corporation, you can write your own ticket, because Mr. Wells has assured me that I would be treated by you the same as he would treat me, which is as fine a recommendation as I would ask.

I have several thousand dollars worth of machinery in this district, also a 20 ton mill set-up at the property, excepting power. The property is six miles from Tonichi and Tonichi is the terminus of a branch of the Southern Pacific RR of Mexico, so our transportation facilities are of the best. Also labor is no problem as we are in the center of San Xavier mining district.

This is probably disjointed, as I have been dictating direct to a typewriter, so if there is any further information that you may wish you can reach me all of next week at this hotel.

There is only one thing that I must impress upon you, that is that time is the essence of any deal we might be able to make. Due to the fact that

I must make that payment within the next thirty days, but I feel sure that any Engineer you might send down with me would whole-heartedly pass upon the property. I want you to understand that I in no way would waste any time or moneys that you might have to pay for your examination.

With kindest personal regards, I remain

Very truly yours,

/s/ D. D KRODER.

P. S.

You spoke of the tax situation, I am sure that if you will look into the tax situation as it exists in Mexico, you will find that it is very advantageous to anyone doing business there and especially under the "Good Neighbor" policy. Also we receive the same price for gold as here in the States but silver is only 46c an ounce.

Again—

/s/ D. D. K.

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 53
Mining Option

This Agreement Made this 31st day of July, 1944, between Daniel Kroder, First Party, and Clayton R. Jones and John C. Higgins, Second Parties, Witnesseth:

1. First party has an option for the purchase of the Tescalama group of mines consisting of four properties, located at La Baranco, Sonora, Mexico. Said option is given by the owner of said mines,

one Juan Robinson, and it provides in substance a purchase price of \$35,000, payable \$10,000 in cash upon the closing of the contract of purchase after examination of titles, and the payment of the balance of \$25,000 shall be made out of a ten per cent royalty on the net smelter returns on all ore, concentrates or bullion produced. No definite schedule of minimum payments is provided but the option does provide that all work on the property shall be done in a workman-like manner and that the total \$25,000 balance on the purchase price shall be paid within a period of four years from the signing of the contract. The option agreement also provides that in case the purchasers shall file on any properties adjacent to those of Mr. Robinson, and if the purchasers for any reason surrender the contract of purchase, such adjacent properties shall be assigned to Mr. Robinson. The option contract also provides that the purchasers have thirty days after the surrender of the contract in which to remove any equipment or any other improvements placed upon the property by the purchasers, except permanent improvements attached to the land.

2. First party hereby grants to second parties an option to purchase first party's aforesaid option agreement with said Robinson, such option of purchase hereby granted to be exercised on or before the termination of first party's option with the aforesaid Robinson. Second parties are to examine the aforesaid mining properties as promptly as is reasonably possible and shall exercise their option of purchase by notice to first party.

3. The terms of the option hereby granted are as follows: If second parties shall exercise their option to purchase they shall agree to provide the sum of \$35,000, \$10,000 thereof to constitute the payment of \$10,000 to be made to the aforesaid Robinson, such payment to be made upon examination and approval of the title to the property and upon the execution and delivery of a deed, in escrow or otherwise, covering the mining properties to a grantee designated by second parties. Second parties shall provide the balance of said \$35,000 as the same may be required for the purchase of such mining and milling equipment as the parties hereto may agree upon and for the payment of such salaries, wages and other expenses as may be required for the installation of the aforesaid equipment and the operation of the mining property. Second parties are to be under no obligation to provide any sums of money beyond the aforesaid \$35,000. If it shall develop that further money is required to put said property into operation, such additional funds shall be procured under such agreement as the parties hereto may then make.

4. Parties hereto contemplate the organization of a Mexican corporation to be named as grantee in the deed conveying said mining property and the \$35,000 provided by second parties hereto shall be in the form of a loan to said corporation represented by notes of the corporation and repayable within two years from their date, with interest at five per cent. Said notes shall be payable either

at or before their maturity before any dividends shall be declared by said corporation.

5. The stock of the aforesaid corporation shall be distributed one-third to first party and two-thirds to second parties.

6. First party agrees to devote all of his time to the management of the affairs of said corporation during a development period of four months and he shall receive therefor a salary of Three Hundred Dollars (\$300.00) per month. In case the parties shall desire to continue the arrangement with first party for his services after said initial period of four months it shall be under such agreement as to salary and terms as may be made by the parties hereto.

7. The deed of conveyance to be executed by the aforesaid Robinson shall also include a bill of sale to be joined in by said Robinson and first party hereto, transferring all of the mining and milling equipment, houses and other structures now on said mining premises.

/s/ DANIEL D. KRODER,
First Party.

/s/ JOHN C. HIGGINS,
Second Party.

/s/ CLAYTON R. JONES,
Second Party.

Witness:

/s/ MARGARET L. STEWART.

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 54

Hotel Laval
Hermosillo, Sonora, Mexico

August 9, 1944.

Messrs. Clayton R. Jones and
John C. Higgins,
Portland, Oregon.

Dear Sirs:

Referring to that certain agreement dated July 31, 1944, and made between the undersigned, as Party of the First Part and yourselves as Parties of the Second Part, I hereby agree that this agreement shall be amended as follows:

In lieu of the participation of thirty-three and one-third per cent ($33\frac{1}{3}\%$) provided in the said agreement, I agree that my interest in the undertaking, should the option from Juan Robinson be exercised, shall be twenty (20%) per cent, which interest shall be divided, ten per cent (10%) to A. E. Johnson, of Tonichi, Sonora, Mexico, and ten per cent (10%) to myself.

All of the other terms of the above-mentioned agreement shall remain in full force and effect.

Yours very truly,

/s/ DANIEL D. KRODER.

Supplemental Agreement

The undersigned are parties to a written agreement dated July 31, 1944, as modified by a letter addressed to the undersigned Jones and Higgins by the undersigned Kroder and dated August 9, 1944.

The undersigned hereby agree that Section "6" of the aforesaid agreement dated July 31, 1944, shall be cancelled and that said Kroder is hereby released from his agreement to devote all of his time to the management of the affairs of the corporation provided for in the aforesaid agreement during a development period of four months, and said Jones and Higgins are hereby released from any obligation to provide for the payment of Three Hundred Dollars (\$300.00) per month to said Kroder for such services.

The cancellation of the aforesaid Section "6" of said agreement of July 31, 1944, and the release of the parties hereto from the obligations stated in said paragraph, shall not in any way release or affect the right of said Kroder under the aforesaid agreement of July 31 as modified by said Kroder's letter of August 9 to said Jones and Higgins to receive a 20% interest in the undertaking provided for in said agreements, said 20% interest to be divided 10% to said Kroder and 10% to A. E. Johnson; nor shall this supplemental agreement in any way modify or release any of the other terms of the contract represented by the aforesaid agreement dated July 31, 1944, as modified by the aforesaid letter of August 9, 1944.

Dated this 31st day of August, 1944.

/s/ CLAYTON R. JONES,

/s/ JOHN C. HIGGINS,

/s/ DANIEL D. KRODER.

Mining Option

[See pages 258 to 261 of this printed record.]

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 55

Trust Agreement

This Agreement of trusteeship between Clayton R. Jones and John C. Higgins, first parties, and D. E. Harris, second party, Witnesseth:

1. First parties are the principal parties in interest under that certain letter of option addressed to D. E. Harris, second party herein, and executed by Juan Robinson dated August 10, 1944, and relating to certain mining claims and properties located in the Municipio San Javier Estado De Sonora Republic of Mexico, said mining claims and properties being located near the town of La Barranca, Senora.

2. Second party herein, hereby declares that he negotiated the contract represented by the afore-said letter of option, as the agent and trustee of the first parties herein, and that all monies heretofore expended and advanced to comply with the terms of said letter of option and to carry on the exploration and development of the mining properties therein referred to, have been provided by the first parties herein, and that the second party herein has no interest in said letter of option or in the properties therein referred to, except as trustee and agent of the first parties herein.

3. It is contemplated between the parties hereto that a written agreement may hereafter be made, wherein and whereby the second party may acquire

Plaintiff's Pre-Trial Exhibit No. 55—(Continued)

an interest in said letter of option and in the mining properties therein referred to, and in the mining enterprise to be conducted by first parties herein in the exploration and development of said properties, but it is hereby agreed and declared that unless and until such written document shall be executed between the parties hereto, the second party shall have no interest in said option or in said properties or enterprise, and that second party's sole relationship thereto is and shall be that of agent and trustee for first parties herein.

Dated at Portland, Oregon this 1st day of September, 1944.

/s/ CLAYTON R. JONES,

/s/ JOHN C. HIGGINS,

/s/ D. E. HARRIS.

State of Oregon,
County of Multnomah—ss.

On this 1st day of September, 1944, before me, Margaret L. Stewart, a Notary Public in and for said State, personally appeared Clayton R. Jones, John C. Higgins and D. E. Harris, known to me to be the persons whose names are subscribed to the within instrument, and acknowledged to me that they executed the same freely and voluntarily for the uses and purposes herein expressed.

In Witness Whereof, I have hereunto set my

Plaintiff's Pre-Trial Exhibit No. 55—(Continued)

hand and affixed my official seal, the day and year in this certificate first above written.

[Seal] /s/ MARGARET L. STEWART,
Notary Public for Oregon,
Residing at Portland.

My commission expires Sept. 28, 1947.

Nogales, Arizona,
August 10, 1944.

Mr. D. E. Harris,

My dear Mr. Harris:

By means of this letter I obligate myself to sell to you, or other person or company that you will indicate to me, the following concession or exploitation of mine with minerals of gold and silver located in the Municipality of San Javier, State of Sonora, United States of Mexico.

1. "Tescalama," with 10 Claims, Title 89.980.
2. "Barranquena," 10 Claims, Title 94.140.
3. "Noche Buena," 9 Claims, Title 105.641.

Also, the right on the mine "Santa Ana," No. 1779, with 8 Claims, with minerals of gold and silver under the same conditions as above, and the houses, machinery and mining equipment that are on these properties, for a price of \$40,000 in money of these United States. This amount is to be paid as follows: \$1,000 which I have received from you which I hereby acknowledge; \$9,000 to be deposited by you

Plaintiff's Pre-Trial Exhibit No. 55—(Continued)

within fifteen days from this date at my disposal to the First National Bank of this city, with instructions that the amount be paid upon execution in the City of Hermosillo, Sonora, of the option and premise of sale as referred to in this letter.

After execution of this document, you will indicate to me the authorized person who is to take possession of the mineral lots described for exploitation for your benefit and for the working of, and everything that is necessary for the taking up of the minerals that are on the surface or for the finding of new deposits with the right to dispose of said minerals, and with the obligation on your part to give me the 10% of the net value upon liquidation of the said metals that are found in these said mines; which amounts will be applied on account of the price.

The \$30,000 remaining is to be paid by you in three installments in one, two and three years from this date, discounting from each installment the amount that you have given me during the year as a result of this participation.

Once the whole total has been paid of the said mines and rights, I obligate to give to you or the persons that you designate the definite deed on the said properties with satisfactory titles of possession.

It is understood for the net value of liquidation the amount that is to be deducted from the gross value that is to take place on each liquidation the following expenses only: duties, railroad expense,

Plaintiff's Pre-Trial Exhibit No. 55—(Continued)

and railroad charges, and as in your case if exportation is required, all expenses in conjunction therewith.

This option or promise of sale that is referred to in this letter is to be signed as soon as you obtain the permission from the Secretary of the Government of the Mexican Republic to do business in that country, and is to bear the clause and conditions appropriate in the case of contracts. In this regard your obligation as buyer is to pay the stamp and duty charges for keeping up of the concession while working the mines during the life of the option, and to keep the properties free and clear from liens in regard to labor and materials. In the same document there will be stipulated that in event of failure to complete the payments mentioned, or within the time stipulated the contract will be rescinded and all amounts received in account of the price are to be held without any obligation as to their return. In this case the buyer can take back within a space of three months the machinery that he has installed in the mines and also materials that he has thereon, leaving, however, in the mines any permanent installations.

If the deposit of \$9,000 mentioned above is not made or if within a time of ninety days from this date you will not obtain the permission from the Secretary of the Government, the present option is to be terminated without obligation on my part to refund your \$1,000 that I have received in this regard.

Plaintiff's Pre-Trial Exhibit No. 55—(Continued)

All of the expense in connection with the writing of the promise of sale, as well as the deed, is in this case for account of the buyer.

In the event that you agree to the terms mentioned above, I ask that you confirm by signing and returning to me the duplicate of this letter.

/s/ JUAN F. ROBINSON.

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 56

Translation

No. 1161.—In the City of Hermosillo, State of Sonora, Mexico on the 31st day of October, 1944, before me, Attorney Horacio Sobarzo, Notary Public No. 5, and the witnesses hereto, Nicasio Ruibal, married, a merchant, and Luis Garnica, a bachelor, a private employee, both of legal age, Mexicans, local residents and without legal disability, appeared Messrs. Jorge F. Robinson, Juan F. Robinson and Miss Ana Robinson, the first two married and the latter single, miners, residents of La Barranca, Municipality of San Javier, in this State, parties of the first part, and, as party of the second part, Mr. Malcom C. Little, an American citizen an attorney, a resident of Nogales, State of Arizona, and temporarily in this place, as President and on behalf of the corporation "Mina del Refugio, S. A.," said parties not being affected by the prohibitions upon Notaries in regard to contracts concerning

Plaintiff's Pre-Trial Exhibit No. 56—(Continued)

enemy properties and business and not requiring a permit from the Intersecretarial Board for the execution of these presents. The contracting parties, all of legal age and personally known to the undersigned Notary, to which I certify, and, in my opinion, competent to contract and obligate themselves, stated that they hereby enter into the agreement, contained in the following declarations and clauses:

Declarations:

I. Messrs. Jorge F. Robinson, Juan F. Robinson and Miss Ana Robinson are referred to herein as the "Owners," and Mina del Refugio, S. A. as the "Company."

II. Mr. Jorge F. Robinson is the grantee and owner of the two following mineral "exploitation" claims, situated in the Municipality of San Javier, Sonora: "Tascalama," containing ten hectares, title No. 89980, issued October 24, 1939, and registered on the same date under No. 622. Vol. 64, page 156, of the General Book of Concessions of the Public Mining Records, November 17, 1939; and "Noche Buena," containing nine hectares, Title No. 105641, issued June 17, 1944, and registered the same day under No. 296, page 75 of Vol. 92, of said General Book of Concessions.

III. Mr. Juan F. Robinson is the grantee and owner of the "exploitation" mineral claim No. 94190, known as "Barranquena," containing ten

Plaintiff's Pre-Trial Exhibit No. 56—(Continued)

hectares, situated in said Municipality of San Javier, Sonora, issued August 12, 1940, and registered on the same day under No. 203, page 51 of Vol. 72, of said General Book of Concessions.

IV. Miss Ana Robinson is the grantee and owner of the "cateo" mining concession known as "Santa Ana," Title No. 97617, containing 9 hectares and situated in said Municipality of San Javier. On January 17, 1944, said grantee applied to the Mining Agency in this place for an "exploitation" concession of the same name and to replace said "cateo" title, which proceeding bearing the No. 1779, is being conducted in said Agency.

V. On September 18, 1944, Mr. Juan F. Robinson applied to said Mining Agency for the following exploitation concessions, situated in said Municipality of San Javier: "Ana Estella," containing 50 hectares, Expediente No. 1898; "Candelaria," containing 11 hectares, Expediente No. 1899; and "Veta Grande," of 9 hectares, Expediente No. 1900. (Note: the "expediente" is the denouncement or location, record.)

VI. Messrs. Jorge F. Robinson owns two-thirds ($\frac{2}{3}$) and Juan F. Robinson owns one-third ($\frac{1}{3}$) of the machinery, equipment, and surface improvements now existing on the "Tascalama" claim, and, of the houses existing on the surface of the "Santa Ana" and "Candelaria" claims, of which the following is an inventory:

Plaintiff's Pre-Trial Exhibit No. 56—(Continued)

- 1—15 Ton Mill.
- 1—6 H.P. Fairbanks Motor.
- 1—Dodge automobile motor.
- 1—Concentration table.
- 1—1-15/16" x 15' shaft.
- 1—36" pulley.
- 1—38" pulley.
- 3—Pulleys of 6", 8" and 12".
- 1—Belt complete for classifier.
- 1—6" x 20' belt.
- 1—3" x 10'.
- 1—Dodge 25 ton crusher.
- 4—Iron bars.
- 2—Small iron bars.
- 200—feet of 2½" pipe.
 - 2—Cylindrical water tanks, of 3' and 4' long, respectively.
 - 1—40 H. P. boiler without tubes.
 - 2—Mine cars complete.
 - 1—car body.
 - 60' of rail.
- 200—Feet of ¾" new pipe.
- 40—Feet of 5/8" strip iron.
 - 1—Wooden flotation machine.
 - 1—Forge.
 - 1—Anvil.
 - 1—One ton tackle.
 - 1—Old Steam hoist.
 - 1—15 H. P. steam cylinder.
 - 1—Small steam pump.
 - 100' of 1½" pipe.

Plaintiff's Pre-Trial Exhibit No. 56—(Continued)

1—5 Ton mill.

1—Wooden Chute.

1—Mill Building.

Santa Ana House.

La Esperanza House.

2000' of rail.

1—Wagon.

450' of 11½" pipe.

1—Old 60 H. P. Boiler.

1—Water heater for boiler.

Mine tools.

Mill tools.

Mill equipment, corrugated iron, bolts, old iron, etc.

Clauses:

First: The owners promise and agree to sell to the Company, or to such competent person or company that it may designate, or to which it may assign its rights hereunder, the mining claims, those to which titles have been issued and to which titles are pending, and the other properties described in the foregoing declarations.

Second: The owners declare that they have complied with all the obligations by law imposed on said properties, that the properties are free of liens and encumbrances, and that the proposed sale shall include all the rights, appurtenances, improvements, easements and accessions thereunto belonging.

Third: The agreed price of said properties shall be \$40,000.00 dollars, American money, which

Plaintiff's Pre-Trial Exhibit No. 56—(Continued)

amount is apportioned among said properties as follows: To the claims "Tascalama" and "Nochebuena," owned by Jorge F. Robinson, \$20,000.00; to the claim "Barranquena," owned by Juan Robinson, \$10,000.00; to the claim "Santa Ana," owned by Miss Ana Robinson, \$3,500.00 to the denouncements referred to in declaration V preceding, \$500.00; and to the machinery, equipment and surface improvements referred to in declaration VI preceding, \$6,000.00.

Fourth: The Owners acknowledge receipt at this time, on account of said purchase price, of the sum of \$10,000.00 dollars, each one of the amount belonging to him. If the Company exercises its right to purchase, the rest of the purchase price, or \$30,000.00 shall be paid: \$10,000.00 on or before August 10, 1945; \$10,000.00 on or before August 10, 1946; and \$10,000.00 on or before August 10, 1947, this latter instalment to be paid at the time of the execution of the final deed of transfer. From each annual instalment there shall be deducted the amount received as royalty during the preceding year by the owners, as provided in clause seven, and the Company shall pay only the difference between \$10,000.00 and the amount in royalties thus received. Deferred payments shall not bear interest. All future payments shall be made in the City of Hermosillo to Juan F. Robinson, and each of such payments shall be divided into two parts: the first in income tax stamps, as provided in Schedule Three,

Plaintiff's Pre-Trial Exhibit No. 56—(Continued)

in the amount due on each payment, as by law provided, and the rest in dollars, the value of the stamps to be determined according to the exchange rate in effect on the day on which payment is made.

Fifth: The Owners place at the exclusive disposition of the Company the mineral claims and other properties mentioned in the declarations aforesaid and grant to it the right to take possession thereof, with all the rights incident to legal possession, to the exclusion of any other person, and, at its own and exclusive expense to use said properties and to explore, work and exploit said mines in such manner as it may see fit, and to extract therefrom, treat, sell and export the ores therein contained and the products derived therefrom.

Sixth: The Company may take to and install on the properties the machinery and equipment that in its judgment are necessary to their operation and make such improvements on the surface or in the mines that it deems advisable.

Seventh: The Owners shall receive, and the Company agrees to pay to them, as a just rental for the use and enjoyment of the optioned properties and as adequate compensation for their depletion, a participation equal to 10% of the net amount realized from the ores extracted from the mines. The "net amount realized" is understood to be the amount remaining after deducting from the gross

Plaintiff's Pre-Trial Exhibit No. 56—(Continued)

value appearing in each liquidation issued by the smelter the following expenses: The smelting charge and other deductions made by the smelter, taxes of every kind or denomination, railroad freight or express to the smelter from the station where the ores or their products are loaded, and, in case of exportation, the expenses on both sides of the border. The smelter is authorized to pay the foregoing expenses and to deduct the same from the gross value of each shipment, so that the net amount appearing on each liquidation shall be the net amount realized therefrom. The smelter is authorized to pay to Juan F. Robinson, if the latter so requests, the amount belonging to the Owners out of the net amount realized from each shipment, and the Company is obligated to pay said amount to the owners if the smelter does not do so, for which purpose a copy of this instrument shall be delivered to the smelter to which the ores and other products are shipped and shall serve as its authority to act as herein agreed. For purposes of this contract the word "smelter" shall apply to any purchaser of the ores or their products.

Eighth: The term of the option contained in this contract is established for the benefit of the Company, and therefore it may exercise its right to purchase herein granted at any time before the expiration of the term, by giving to the Owners ten days advance notice. After the expiration of the ten days, the Company may demand a deed from the

Plaintiff's Pre-Trial Exhibit No. 56—(Continued)

Owners. From the price stated in clause three above there shall be deducted the sum received by the Owners in royalties, as provided in clause seven, and therefore when the money thus received by the Owners amounts to \$30,000.00, they shall be obligated to grant to the Company, or assigns, a deed of sale to all of the properties included in this option. The Owners shall be also so obligated, even before receiving in royalties the amount of the purchase price, if the Company, at the time of execution of the deed pays to them an amount sufficient to complete the purchase price. When such deed is made the Company is authorized to retain out of the unpaid portion of the purchase price and to pay to the tax offices, any income tax due on the transaction and any such tax due prior to the date of the transfer.

Ninth: In addition to the foregoing the Company shall be obligated, during the life of this contract: (1) To keep account books in accordance with present or future laws, therein entering accounts of ores treated or sold, and permit the Owners, by their representative and during office hours, to inspect such accounts to determine their correctness and to take copies thereof. (2) To do the annual work necessary to keep the mine titles in force, to pay during the months of January, May and September of each year the taxes due on said mines, and to pay the production, ad valorem and other taxes assessed against the ores and mineral prod-

Plaintiff's Pre-Trial Exhibit No. 56—(Continued)
ucts sold or exported and not paid by the smelter.

(3) To permit the Owners, by their representative and at his risk, to enter the mines to inspect the operations and work being carried on therein.

(4) To pay for the material purchased and labor employed in the operation of the properties and legal claims for occupational injuries.

Tenth: The Owners declare that there are no contracts in force affecting said mineral claims and appurtenances, or authorizing their work or exploitation, and they obligate themselves, during the life of this contract, not to perform any acts or execute any contracts that directly or indirectly, might injuriously affect the rights hereby acquired by the Company or interfere with the exercise thereof, and all things done in violation of this obligation shall be void.

Eleventh: If, due to political disturbances, strikes, unsurmountable transportation difficulties, labor or legal troubles, intervention by the jure or de facto authorities, fires, cave-ins or other circumstances beyond the control of the Company, the Company should have to suspend operations, the terms herein stipulated shall be considered as extended for a time equal to such suspensions, if the Company so requests in writing, advising the Owners of the beginning and end of such suspensions, but such suspensions shall not taken together exceed one year; but the obligation to pay the Owners their participation in the net amount realized from ores sold, the payment of taxes, and

Plaintiff's Pre-Trial Exhibit No. 56—(Continued)

doing the minimum annual work by law required shall not be suspended for any cause.

Twelfth: If the Company does not pay to the Owners the price agreed upon, as provided in clauses three and four hereof, or does not pay the participation referred to in clause seven, or does not pay the mining taxes, or does not do the necessary annual work to keep the titles to said claims in force, and if such failure of compliance continues for thirty days, because of any of such causes this contract may be rescinded.

Thirteenth: If, in the judgment of the Owners, the Company should fail to comply with any of the obligations mentioned in the preceding clause, within thirty days from the date of such supposed default, the Owners shall notify the Company thereof by registered mail, with return receipt, therein stating the cause for such notice. If the Company has defaulted, it shall have thirty days within which to remedy the default and if it does not do so within said period, the Owners may proceed by suit to rescind this contract, the Company reserving all rights in connection therewith.

Fourteenth: If this contract terminates for any cause other than the purchase of the properties by the Company, possession by the Company shall cease and the properties shall be returned to the Owners who shall retain as damages payments previously made, but the Company shall not be liable for deterioration. The Company, may, within

Plaintiff's Pre-Trial Exhibit No. 56—(Continued)

three months following such termination, dismantle and remove the machinery and equipment it has installed at the mines and all materials not affixed to the soil, but it cannot remove from inside the mine rails, timbers and other supporting structures.

Fifteenth: Taxes on payments which under this contract are received by the Owners shall be paid by the Owners.

Sixteenth: The parties designate the City of Hermosillo, Sonora, as the place for the performance of this contract, and they subject themselves to the courts or said city in all matters relating to its interpretation and performance. For purposes of article 1069 of the Commercial Code the Owners designate House No. 144 Calle Hidalgo, and the Company the office of the Banco Nacional de Mexico, both in said City, for service of process and the conduct of such proceedings as may be necessary.

Seventeenth: Any notice that one of the parties desires to make on the other shall be considered as made ten days after the date on which it is deposited in a Mexican post office, registered, with return receipt, with proper postage and addressed to the party to be notified at the respective address mentioned in the preceding clause, the Owners to send signed copies of such notices, by registered mail with return receipts, to Mr. John C. Higgins,

Plaintiff's Pre-Trial Exhibit No. 56—(Continued)

1303 Public Service Building, Portland, Oregon, U.S.A. However, the parties may serve notice on each other by any other legal methods.

Eighteenth: The Owners appoint as their representative, in relation to this contract, Mr. Juan F. Robinson, and they empower him to receive payments, execute receipts and acquittances, distribute among the Owners the moneys received hereunder, and to deal with the Company in all matters hereunto pertaining and all that said Mr. Robinson may do in the premises shall be binding upon the Owners.

Nineteenth: The Owners consent to the assignment by the Company of this contract and of the rights hereunder acquired to any competent person or company, on condition that such assignee assume all of the obligations herein incurred by the Company, and that there be delivered to Mr. Juan F. Robinson, or to any other one of the Owners, a testimonio (certified copy) of the instrument of assignment. When such instrument is executed the obligations hereunder of the Company shall cease.

Twentieth: If the Company elects to exercise its right to purchase said properties, and if, in accordance with prohibitive laws, it cannot acquire them, either directly or through other competent person or corporation, without the requirement that Mexican nationals own part of its capital stock and be members of its Board of Directors; or if, for any

Plaintiff's Pre-Trial Exhibit No. 56—(Continued)

other cause, the Company or its assigns, as the case may be, cannot acquire said properties, the Owners expressly agree, in such case, and if the purchase price is paid in full, as above provided, that the Company, or assigns, may continue in possession of said properties and exploit them for ten years more, from the date of expiration of the term of this contract, and thus successively by decades until the ores are exhausted; and the money previously paid by the Company on account of the purchase price shall be considered as rent, for the entire period of such extension, for the use and enjoyment of the properties and as compensation for their depletion, without obligation on the part of the Company to pay anything more, except the expenses and taxes caused by such new situation, but without prejudice to the obligation of the Owners to execute a proper deed whenever the laws so permit.

Twenty-first: All expenses arising from this contract and from the execution of the deed, if a deed is executed, shall be paid by the Company, except expenses connected with Income Tax, which shall be paid by the Owners.

As evidence of his legal residence in the country, Mr. Malcolm C. Little exhibited a document the relevant part whereof is as follows: "United States of Mexico.—Department of the Interior.—Immigration Service.—No. 8083.—Form 10.—In accordance with the exemptions provided in article 68 of the present immigration law, as applied to foreigners

Plaintiff's Pre-Trial Exhibit No. 56—(Continued)

legally admitted into the country and who, by reason of their business, have to leave and enter . . . authority is granted to Mr. Malcolm Cutler Little . . . married . . . an American citizen, a legal resident of the country, holder of . . . the official receipt No. 9242717, issued by the National Registrar of foreigners.—Nogales, Son., July 20, 1944.—Director of Immigration.—Abel Boza Aleman.—Scroll.—Official Seal.”

As evidence of his authority to act herein, Mr. Malcolm C. Little also exhibited the following documents:

(a) A first certified copy of instrument No. 644, of January 5, 1932, executed in the City of Nogales, Sonora, by Lic. Arsenio Espinosa, Notary Public No. 6, containing the articles of incorporation of “Mina del Refugio, Sociedad Anonima,” there appearing on said document a notation showing that it was recorded in the special Mining Record, Vol. 1, No. 62, January 13, 1932. The relevant parts of said document are as follows: First.—The name of the Company is “Mina del Refugio, Sociedad Anonima.” Second.—The main domicile of the Company is the City of Nogales, Sonora . . . Third.—The purposes of the Company are: (a) To acquire, exploit and alienate mining claims and concessions . . . (b) To acquire, exploit and alienate industrial plants and installations, buildings and lands necessary or conducive to the foregoing purposes . . . (d) . . . and, in general, the execution of

Plaintiff's Pre-Trial Exhibit No. 56—(Continued)

all contracts and the performance of all acts necessary or conducive to the realization by the Company of said purposes. Fourth.—The period of duration of the Company is fifty years, which period shall terminate December 31, 1982 . . . Seventh.—The Company shall be governed by a Board of Directors, consisting of not fewer than three nor more than seven members, who will elect from among themselves a President, a Vice-President, a Secretary and a Treasurer. One person may hold two offices.—The Board of Directors shall have the following powers: (a) To carry on all operations, perform all acts and execute all contracts required by the corporate purposes . . . including acts of “dominion,” such as to sell, pledge or otherwise to encumber . . . corporate properties . . . to buy subject to term payments . . . (b) To represent and to cause the Company to be represented in and out of court, with full powers . . . (e) Such other powers as are conferred by law or the by-laws of the company and that are not expressly reserved to the stockholders . . . By-Laws . . . Article 39.—The President shall have the following powers: 1. To represent the Company in and out of court and as such to exercise the powers conferred by law and by these by-laws . . . 2. . . . To represent the Company before all authorities, political, administrative or judicial, federal, local or municipal and conduct all kinds of negotiations, even those that require a special grant of authority in connection with the

Plaintiff's Pre-Trial Exhibit No. 56—(Continued)

principal matter in hand, incidents thereto and recourses, including the authority to make bids and counter-bids . . . 3. To denounce, apply for, buy or otherwise acquire mining claims and concessions, to manage and lease the properties of the Company; to enter into contracts and perform all kinds of acts, civil or mercantile, required by the ordinary business of the Company; to execute the necessary public (notarial) and private (before witnesses) documents that may be required . . .

(B).—The Minute Book of meetings of stockholders and of the Board of Directors of "Mina del Refugio, S. A.," duly authorized by the Director of the Federal Tax Office of the City of Nogales, Sonora, January 22, 1932, on pages six to nine whereof appear the minutes of a regular meeting of stockholders held January 20, 1943, the relevant part whereof being as follows: "In Room four of the Banco Ganadero and Agricola, S. A. Building, in Nogales, Sonora, at 10 a.m. on January 20, 1943, there met the stockholders of "Mina del Refugio, S. A." whose names appear in the list of attendance attached to the record of this meeting . . . The President and Secretary being absent, the Vice President, Mr. Enrique Torres, Jr., acted as Chairman and Miss Donnadiou by special appointment acted as Secretary. All the shares into which the capital stock is divided being represented, notice of the meeting was waived as provided in article 16 of the bylaws of the Company, and the Chairman

Plaintiff's Pre-Trial Exhibit No. 56—(Continued):

declared the meeting legally convened and explained that the purpose of the meeting was to take up the matters referred to in article 181 of the Incorporation Law. Thereupon the following resolutions were adopted by unanimous vote:

First: Resolved to elect as members of the Board of Directors and as officers for the corporate year of 1943, and until their successors are elected, the following persons: Malcolm C. Little, W. C. Taylor and Enrique Torres, Jr., the first as President, the second as Vice-President and the third as Secretary and Treasurer.

Second: There being no further matters before the meeting, the same was adjourned and these minutes were inscribed in the minute book and were signed by all those present . . .”

The matters hereinbefore related or inserted are true copies from the respective originals, which originals I certify to have seen and to have returned to the interested parties and that, as shown by said Minute Book, a new Board of Directors has not since been appointed.

There were present at the execution of these presents Mrs. Guadalupe M. de Robinson and Mrs. Viriginia L. de Robinson, both of legal age, competent to contract and obligate themselves, personally known to the undersigned Notary, who stated that they grant to their respective husbands, Juan F. Robinson and Jorge F. Robinson, their consent, as by law required, to the execution of this instrument, to which they agree.

Plaintiff's Pre-Trial Exhibit No. 56—(Continued):

With respect to Income Tax the contracting parties stated that they do not owe any such tax and neither does the company represented by Mr. Little.

And this document having been read to the contracting parties and its legal value and effect having been explained to them, likewise the need of recording the same, they ratified and signed it before me and in the presence of said witnesses.—I certify.—(Signed) Juan F. Robinson.—J. F. Robinson.—M. C. Little.—Guadalupe M. de Robinson.—Virginia L. de Robinson.—Ana Robinson.—N. Ruibal.—L. Garnica.—Scrolls.

On the 9th day of the following month of November, the day on which the stamp and income taxes were paid, I authorize this instrument.—I certify.—(Signed) Horacio Sobarzo.—Scroll.—Notarial Seal.

The same seal in the margin and cancelled income tax stamps to the value of \$4,204.95 pesos, and common stamps to the value of \$60.20, and \$6.02, or 10% additional tax.

“Citizen Director of the Federal Tax Office, Present.—Under number 1161, before me on this day there was executed a document in which Juan F. Robinson, Jorge F. Robinson and Ana Robinson promised and agreed to sell to the company “Mina del Refugio, S. A.,” or to such competent person or company that it might designate, the exploitation mining concessions “Tascalama” and “Noche

Plaintiff's Pre-Trial Exhibit No. 56—(Continued): Buena," for \$20,000.00 dollars; the exploitation mining concession "Barranquena" for \$10,000.00 dollars; the cateo mining concession "Santa Ana," for \$3,500.00 dollars; the denouncements "Ana Estela," "Candelaria" and "Veta Grande" for \$500.00 dollars, all of which concessions are situated at San Javier, in this State; and the machinery, equipment and surface improvements existing on the "Tascalama" claim, for \$6,000.00 dollars.—The optionors received at the time of signing this instrument, on account of said purchase price 25%, or, on account of the mining claims, \$8,500.00 dollars and \$1,500.00 on account of the equipment, machinery and surface improvements aforesaid. In the same instrument said Messrs. Robinson named Juan F. Robinson as their common representative in relation to this contract, to receive payments, sign receipts, etc. Said document is contained on seven sheets of the Protocol. Pursuant to articles 83 and 88 of the Regulations of the Income Tax Law the document is subject to a tax of \$4,204.95 in stamps under Schedule III on \$8,500.00 dollars, which is 25% of the purchase price of the mines, which please cancel on this return, affixing the body of the stamps to the original and the stubs to the duplicate, as provided in article 83.—Also and in accordance with section 44, subsection I, letter (a) the promise to sell the equipment, machinery and improvements for \$6,000.00 dollars, at the official exchange rate of \$4.85 for 1,

Plaintiff's Pre-Trial Exhibit No. 56—(Continued) :

is subject to a tax in common stamps of \$58.20, and \$5.82, or 10% additional, and, as provided in section 42, subsection I of the Tarif, \$2.00 in common stamps and \$0.20 or 10% additional, which please cancel on this return. With respect to the Income Tax Law the parties state, Mr. Malcolm C. Little for "Mina del Refugio, S. A." and Messrs. Robinson, that they owe no such tax. Hermosillo, Sonora, October 31, 1944.—The Notary, Horacio Sobarzo, Scroll."

The Director of the Federal Tax Office in this City certifies: that on this day the following taxes were paid: Income Tax, Schedule III, \$4,204.95; in common stamps \$58.20 and \$5.82, or 10% additional; and \$2.00 in common stamps and \$0.20, or 10% additional, in accordance with the liquidation made by and subject to the responsibility of the subscribing Notary.—Hermosillo, Sonora, November 9, 1944.—J. Chavez E.—Scroll.—Official Seal.

This First Copy of the First Testimonio Was Taken From the Original For the Use of "Mina Del Refugio, S. A." It Is Contained On Eight Sheets, Duly Compared, with the Stamps By Law Required, Duly Cancelled, and It Is a True Copy of the Original.—I Certify.

Hermosillo, Sonora, November 9, 1944.—(Signed) Horacio Sobarzo.—Notarial Seal.

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 57

Agreement Between Mina Del Refugio, S. A.
and

Clayton R. Jones, D. E. Harris and John C. Higgins

Declarations:

I.

Messrs. Clayton R. Jones, D. E. Harris and John C. Higgins are referred to herein as "First Parties" and Mina del Refugio, S. A., as the "Company."

II.

First Parties have procured the granting of an option to the Company for the purchase of certain mining claims, including certain equipment thereon, located in the Municipality of San Javier, Sonora, together with the right to explore, work and exploit said mines pending such purchase, all as set forth in that certain option agreement entered into on the 31st of October, 1944, between the Company and Juan F. Robinson, Jorge F. Robinson and Ana Robinson; said mining claims are referred to herein as the Robinson mining properties.

III.

First Parties have expended the sum of \$10,000 U. S. Currency (48,500 Mexican pesos) in making the first payment on the purchase price under said option, and have also expended further sums totaling \$13,668.40 U. S. currency (66,281.74 Mexican pesos) in the investigation, exploration, development and equipment of said Robinson mining properties for operation under said option agreement.

Plaintiff's Pre-Trial Exhibit No. 57—(Continued):

IV.

The Company will require further large sums of money and additional equipment and materials to continue the exploration, development and exploitation of said mining properties and to make further payments on the purchase price thereof, and First Parties hereby offer to provide the Company with money and equipment and materials for the foregoing purposes under the following terms and conditions:

Clauses:

First: First Parties shall provide such sums of money and such items of equipment, materials and supplies for the foregoing purposes as shall be mutually agreed upon by the Company and First Parties, and as consideration therefor, and as consideration for the procurement of the aforesaid option, the Company shall be bound to First Parties as follows:

(a) Promptly after the execution of this agreement, the Company shall execute and deliver to each of First Parties its notes for the full amounts theretofore expended by such party for and on account of the investigation, examination, exploration, development and equipment of the Robinson mining properties, and for payment on the purchase price under the aforesaid option agreement thereon; said notes shall be payable two years after date and shall bear interest at six per cent per annum from the date when the principal sum represented by such note was expended by the payee for

Plaintiff's Pre-Trial Exhibit No. 57—(Continued):
the purposes above stated, interest being payable at the maturity of the note.

(b) On or about the last day of each month hereafter, the Company shall execute and deliver to each of the First Parties its note or notes for all amounts advanced to the Company or expended for its benefit by such party during such month, at the request of the officers of the Company, for or on account of the exploration, development, equipment or exploitation of the aforesaid Robinson mining properties or for payment on the purchase price under the aforesaid option agreement, or for other Company purposes; said notes shall be payable two years after date and shall bear interest at six per cent per annum from the date of the advance or the expenditure by the payee of the principal sum represented by such note, interest being payable at the maturity of the note; provided, however, that promptly after the execution of this agreement, First Parties shall pay to the Banco Nacional de Mexico, at Hermosillo, Sonora, for credit to the account of Arthur E. Johnson, Trustee, for the use and benefit of the Company, the sum of 5,000 pesos, Mexican currency; said sum shall be in full payment of the "capital social" of the Company, and shall constitute the Company's "capital social" without any obligation or indebtedness therefor from the Company to said Jones, Harris and Higgins, and without the issuance of any note or notes therefor, and the capital stock of the Company shall thereby become fully paid.

Plaintiff's Pre-Trial Exhibit No. 57—(Continued):

(c) Upon demand of the parties entitled thereto, the Company shall execute and deliver to each of the First Parties its note or notes, payable two years after date, for the agreed purchase price and reasonable value of all used equipment heretofore or hereafter sold and delivered to the Company; the principal sum of said note or notes shall bear interest at six per cent per annum from the date or dates when the equipment represented thereby shall have been delivered for use at the Robinson mining properties, said interest being payable at maturity.

(d) All monies advanced or expended by First Parties for any of the purposes described in Clauses (a) and (b) above, together with the amounts representing the reasonable purchase price and value to the Company of the mining and milling equipment sold and delivered to the Company as stated in Clause (c) above, together with interest thereon in accordance with the terms above stated, shall become obligations of the Company from the dates when such monies were advanced or expended and from the dates of delivery to the Company of the aforesaid equipment, and the Company shall be and remain indebted under open account for the aforesaid amounts and interest therein as aforesaid to the respective persons who advanced or expended the monies or who sold and delivered the equipment, until such persons shall have been reimbursed by the Company therefor or until the Company shall have executed and delivered to such persons its note or notes therefor as above provided.

Plaintiff's Pre-Trial Exhibit No. 57—(Continued):

(e) Upon demand therefor by the party entitled thereto, the Company shall execute and deliver to each of the First Parties chattel mortgages on all items of equipment sold and delivered to the Company by such party, giving to such party a lien on such items of equipment to secure the payment of the purchase price therefor and the interest thereon as above provided.

In Witness of the execution of this agreement on this 20th day of November, 1944, the First Parties have subscribed their names hereto and the Company has caused its name to be subscribed hereto by its President and Secretary thereunto duly authorized.

/s/ D. E. HARRIS,
/s/ CLAYTON R. JONES,
/s/ JOHN C. HIGGINS,
First Parties.

Witness:

/s/ MARGARET L. STEWART,
/s/ JANET J. ARNOLD,
MINA DEL REFUGIO, S. A.

By /s/ JOHN C. HIGGINS,
President.

By /s/ D. E. HARRIS,
Secretary.

Witness:

/s/ MARGARET L. STEWART,
/s/ JANET J. ARNOLD.

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 58

Meeting of Directors

At ten o'clock a.m. on the 20th day of November, 1944, the Board of Directors of "Mina Del Refugio, S. A.," met in Room 504 of the Board of Trade Building in Portland, Oregon, there being present Dennison E. Harris, Clayton R. Jones and John C. Higgins, constituting the full membership of the Board.

Mr. Higgins presided as Chairman, and Mr. Harris acted as Secretary.

Mr. Higgins, as President of the Company, stated that the purpose of the meeting was to consider a plan that would enable the Company to procure the money necessary for the exploration, development, operation and acquisition of the mining claims situated in the Municipality of San Javier, Sonora, described in the option thereon taken by the Company on the 31st of October, last, from Juan F. Robinson, Jorge F. Robinson, and Ana Robinson.

Thereupon Mr. Jones presented to the Board for its consideration a draft of a proposed agreement between the Company and Messrs. Harris, Jones and Higgins as individuals whereby they offered to advance to the Company funds for the foregoing purposes upon terms as stated in said draft.

A copy of said proposed agreement is included in the record of this meeting.

After full consideration of said proposed agreement, the following resolutions were adopted by unanimous vote:

First: Resolved that said proposed agreement be and the same is hereby accepted and ratified, and the President and Secretary of the Company are hereby authorized and directed to execute said agreement in quadruplicate in the name of the Company and to deliver an executed copy thereof to each of said individuals, Harris, Jones and Higgins, retaining one executed copy for the Company's files.

Second: Resolved that either the President or the Vice President of the Company is authorized and directed to execute and deliver to Messrs. Jones, Harris and Higgins, upon their respective demands, notes of the Company in accordance with the terms of said agreement, in such amounts and at such times as the officers of the Company shall determine are required by the terms of said agreement in consideration for the following:

(a) All monies heretofore or hereafter expended by said Jones, Harris and Higgins, respectively, for and on account of the examination of the properties covered by the aforesaid option and the acquisition of said option and the making of payments thereunder;

(b) All monies heretofore or hereafter advanced or expended by said Harris, Jones and Higgins, respectively, for and on account of the exploration and development of the mining claims covered by the aforesaid option and the prosecution of mining operations thereon;

(c) All monies heretofore or hereafter advanced

Plaintiff's Pre-Trial Exhibit No. 58—(Continued):

or expended by said Jones, Harris and Higgins, respectively, for and on account of the purchase, repair, transportation and delivery of mining equipment, materials and supplies used on and in connection with the exploration, development and mining operations carried on by said Jones, Harris and Higgins and/or by this Company on the mining properties covered by said option;

(d) All monies advanced or paid out by said Jones, Harris and Higgins, respectively, for expenses or other obligations of the Company incurred in the course of its business, or deposited by said Jones, Harris and Higgins, respectively, to the credit of Arthur E. Johnson, Trustee in the Banco Nacional de Mexico or the First National Bank of Nogales, and thereafter expended for the use and benefit of the Company; provided, however, that said Jones, Harris and Higgins shall promptly hereafter pay to the Banco Nacional de Mexico, at Hermosillo, Sonora, for credit to the account of Arthur E. Johnson, Trustee, for the use and benefit of the Company, the sum of 5,000 Pesos, Mexican currency; said sum shall be in full payment of the "capital social" of the Company and shall constitute the Company's "capital social" without any obligation or indebtedness therefor from the Company to said Jones, Harris and Higgins, and without the issuance of any note or notes therefor and the capital stock of the Company shall thereby become fully paid;

(e) For such amounts as shall represent the rea-

Plaintiff's Pre-Trial Exhibit No. 58—(Continued):

sonable purchase price and value to the Company of all mining and milling equipment, materials and supplies owned by said Jones, Harris and Higgins, respectively, and sold and delivered by them to the Company for the Company's use in the exploration, development and mining of the properties described in the aforesaid option.

Third: Resolved that all monies advanced or expended by said Harris, Jones and Higgins for any of the purposes described in Clauses (a), (b), (c), (d) above, together with the amounts representing the reasonable purchase price and value to the Company of the mining and milling equipment, materials and supplies sold and delivered to the Company as stated in Clause (e) above, together with interest thereon in accordance with the terms of the aforesaid proposed agreement, shall become obligations of the Company from the dates when such monies were advanced or expended and from the dates of delivery to the Company of the aforesaid equipment, materials and supplies, and the Company shall be and remain indebted under open account for the aforesaid amounts and interest thereon as aforesaid to the respective persons who advanced or expended the monies or who sold and delivered the equipment, materials and supplies, until such persons shall have been reimbursed by the Company therefor or until the Company shall have executed and delivered to such persons its note or notes therefor as above provided.

Fourth: Resolved that the President or the Vice President, together with the Secretary, of the Com-

Plaintiff's Pre-Trial Exhibit No. 58—(Continued) :

pany is authorized and directed to execute and deliver to Messrs. Jones, Harris and Higgins, respectively, such chattel mortgages or other documents of security as may be required in accordance with the terms of the aforesaid proposed agreement covering such equipment, materials and supplies as may be sold and delivered to the Company by said Jones, Harris and Higgins, respectively.

The President further declared that in his opinion it would expedite the business of the Company if a branch office of the Company were established in the City of Portland, Oregon, and thereupon, by unanimous vote, the following resolution was adopted:

Resolved, that a branch office of the Company be and the same is hereby established in the City of Portland, State of Oregon, U. S. A., at Room 817, Board of Trade Building, in said city, and that meetings of the Board of Directors of the Company may be held at such branch office from time to time as the Board may determine.

It was also, by unanimous vote, resolved to authorize Malcolm C. Little to protocolize these minutes.

The record of this meeting consists of the following documents: a copy of the minutes signed by the directors present and a copy of the proposed agreement referred to in the minutes between the Company and Messrs. Jones, Harris and Higgins.

/s/ JOHN C. HIGGINS,

/s/ D. E. HARRIS.

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 59

Agreement

This Agreement, between Clayton R. Jones, John C. Higgins and D. E. Harris, Witnesseth:

1. The parties hereto entered into an agreement of trust under date of September 1, 1944, relating to certain mining claims and properties located near the town of La Barranca, Sonora, Mexico. Said agreement of trust is hereby cancelled.

2. In proceeding with the acquisition, development and exploitation of the said mining properties, the parties hereto agreed that the contract of lease and option covering said properties, which had originally been executed between Juan F. Robinson and said D. E. Harris, under date of August 10, 1944, should be assigned by said Harris to Mina del Refugio, S. A., a Mexican corporation, and said contract of lease and option is now held by said Corporation.

3. It was also agreed by and between the parties hereto that funds for the acquisition, exploration, development and exploitation of said mining properties, should be contributed as follows: \$3,000 by said D. E. Harris and members of his family; 50% of the balance of said funds by Clayton R. Jones, and 50% thereof by John C. Higgins. In pursuance of said agreement, said D. E. Harris has heretofore contributed \$1,500; Robert F. Harris has contributed \$1,000 and R. Blaine Harris, has con-

tributed \$500, making a total contribution by said Harris and members of his family, of \$3,000. Said Clayton R. Jones and John C. Higgins have each contributed approximately \$15,000 in cash and they have each made additional substantial contributions in mining and operating equipment, and they plan to make further contributions of cash and operating equipment.

4. It has been agreed by and between the parties hereto that ten per cent (10%) of the stock of the aforesaid Corporation shall be issued to Arthur E. Johnson, or his assigns, ten per cent (10%) to Daniel D. Kroder, or his assigns, and the remaining eighty per cent (80%) of the stock of said Corporation shall be divided between Clayton R. Jones, John C. Higgins and the above-named members of the Harris family, in proportion to their respective contributions in cash and in equipment, at its reasonable value, and that such stock shall be so distributed when the total of said contributions, as finally made, has been determined.

It has also been agreed by and between the parties hereto that all of the contributions of said parties, except the amount thereof required to pay up the 5,000 pesos capital stock of said Corporation, shall be regarded as loans to said Corporation, to be represented by notes of said Corporation and to be repayable within two years from the respective dates when said contributions in cash and equipment were made, with interest at five per cent (5%) per annum, and that said notes shall be payable

either at or before their maturity, before any dividends shall be declared by said Corporation.

Dated this day of March, 1945.

/s/ CLAYTON R. JONES,

/s/ JOHN C. HIGGINS,

/s/ D. E. HARRIS,

/s/ R. F. HARRIS,

/s/ R. BLAINE HARRIS.

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 60

Walter M. Wells

71 Broadway

New York (6)

April 17, 1945.

Mr. Clayton R. Jones,
Board of Trade Bldg.,
Portland, Oregon.

Dear Clayton:

Kroder has sent to his sister, Mrs. Scott, his assignment of the nine per cent of the mine he had been holding. She now has a total of eleven per cent which includes the one per cent Johnson agreed to give her.

In the next couple of days, I will be dropping you a note and telling you how the eleven per cent will be divided—it will probably be between two or three of us. What kind of a document will you wish us to send you showing that the individuals

have a right to the percentages I will tell you about? It was my idea that you would probably want photostats of Kroder's assignment for the nine per cent and of Mrs. Scott's two per cent. In addition, I suppose you would want a photostat of the assignment showing how the eleven per cent is divided.

For your information, we have agreed to pay Kroder \$5,000 and have also released him of a small sum which we advanced some period back. However, the deal is closed and from here on I hope we can get something out of it. If you get any further reports, you know that I now have a double interest in knowing how the mine is progressing.

Until next week or so, I remain

Sincerely yours,

/s/ M. WELLS.

Original—Air Mail

CC—Regular Mail

4/23/45 CC J. C. Higgins

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 61

July 29th, 1945.

Messrs. Higgins & Jones,
1303 Public Service Bldg.,
Portland 4, Oregon.

Report on Tescalama Mine

Dear Sirs:

At this time development of the Tescalama mine appears to be in a most favorable position. The gratifying results obtained during the month, in which we drove the 200-ft. level 131 feet and a 40-ft. raise to the 153-ft. level, have increased our reserve tonnage and gross value to the point where milling becomes advisable.

The map and data which I am attempting to get into the mail to you tomorrow (past midnight now) will show with reasonable certainty and in accord with mining practice that our ore reserve, north of the shaft now stands at 7,335 tons, width averages 5.5 ft. and \$34.29 per ton in gold and silver in short tons and U. S. dollars. By giving the metric assays a conservative value of \$1. per gram gold and \$12.80 per kilogram of silver the resulting gross value is \$251,481.00.

The unconventional vein habits and structure in this shale formation retarded progress in the earlier months of development, but this problem is now pretty well in hand. The cross-cuts, with their short raise and floor pits, have not only paid well, but have revealed with much regularity the big effects of the thrust fault. As is shown on the assay map,

the impoverished vein filling along the last 100 feet of the 153-level is only a mask over the rich ore shoot lying a few feet below the floor, and which is now continuing past the sickly looking end of the 153-level. On the map it will be noticed that the northeasterly course of the vein is on a straight line and the 153- and 200- level running parallel and uniform dip. It looks well for continuation in this line.

There are many details which could be added to this report data which this urgent time limit may not permit. The constant vigilance required in keeping contact with the ore meant my daily stays at the mine, leaving only nights for mapping and recording and analyzing the day's data, and the tomorrow's direction. The deflection at end of 200-level shows what can happen during three days' absence from mine while confined to office work.

As there probably are no blue-printing places at Hermosillo please have printed in black & white several extra copies of the accompanying assay map tracing for my use and mail to me.

It is hoped that the inclosed data and assay map will for the next few days suffice in giving you the basic information required for your next payment decision. Most of this is still on my working pencil sheets, not yet typed, which I shall inclose in this time emergency.

A summary of ore reserves in the newer development follows:

Of the ore reserve blocks the outstanding one, of

course, is Block "C," entirely within our new development. For extra caution I have drawn the limiting line "g"- "h" at only 25 feet below the 200-level, well within the customary allowance. However, the strength and regularity of the vein on this lowest level deserves the immediate driving of the proposed 250-level from the bottom of the winze. As we drove the 135 feet of the 200-level and the new raise from 200-level to the 153-level during the calendar month of July, besides other work in the raises, cross-cut and pits, we reasonably could hope to nearly duplicate an equal program below present bottom. If this ore body should prove to be of same length and value in the next 100 ft. of slope depth it would add another \$460,000 to the reserves appearing in this report. It is also to be noted that the ore appears to be continuing in good shape beyond present face of 200-level, although samples from the face and close inspection are at this writing not available.

Probable Ore:

Assuming that all Tescalama ores are to be milled on the ground, making a \$15.00 ore profitable, we could count on about 3,000 tons left in the old part of the mine together with an equal amount beyond the margins. The performance of the 200-level, of course, gives much hope in the extension of the rich ore shoot.

(Necessary to close here for mail departure.)

I shall try to get some comments on milling at next opportunity.

Yours very truly,

A. J. KLAMT.

Summary of Ore Reserves

Blocks A-B-C-D-E

Block A	1967 Tons @ \$22.80.....	\$ 29,115.60
	-750 Tons/	
	<hr/> 1277 Tons/	
Block B	1521 Tons	
	-221 Tons	
	<hr/> 1300 Tons @ \$24.11.....	\$ 31,343.00
Block C	1328 Tons @ \$28.11.....	\$ 36,818.00
Block D	1350 Tons @ \$76.20.....	\$ 97,200.00
Block E	1846 Tons @ \$101.20.....	\$186,815.00

Stored Broken Ores

Dump, at portal of Main Tunnel, before 200-level additions — 1220 tons @ \$ 22.00.....	\$ 26,840.00
Dump, at portal of Main Tunnel—	
220 tons from 200-level @ \$ 60.00....	\$ 13,200.00 (included above)
	(in block D)
Dump, at portal of Main Tunnel—	
pation 60 tons in piles @ \$ 40.00....	\$ 2,400.00
Stored in Winze 180 tons @ \$100.00.....	\$ 18,000.00 (in block D)
Shipment No. 2, 31 tons @ \$ 35.00.....	\$ 1,085.00

Total — 8,352 tons @.....\$409,163.00

Basis of conversion: Gram-Tonelada to USA-short ton

Used 1 gram gold@ \$ 1.00

Used 1 kilo silver@ \$12.80 (1000 grams)

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 62

March 21, 1946.

Air Mail

Mr. Malcolm C. Little, Attorney at Law,
Nogales,
Arizona,

Dear Mr. Little:

In accordance with our telephone conversation today I am sending you herewith an original and one copy of each of the agreements concerning our Mexican venture, which relate in any way to Mr. Johnson's stock interest therein or to his functions as our agent and trustee.

Upon reading these agreements you will note that Mr. Jones and I purchased the original option agreement between Daniel D. Kroder and Juan Robinson under an agreement dated July 31, 1944. Under that agreement Jones and I undertook to provide certain sums of money, up to \$35,000, to make the first option payment to Robinson and to provide for a limited amount of development on the property, a corporation was to be organized to own the property, and our cash contributions were to constitute loans to the corporation to be represented by notes which were to be payable before any dividends were declared. The stock of the corporation was to be distributed $\frac{1}{3}$ to Kroder and $\frac{2}{3}$ to Jones and myself.

On August 9, 1944, a supplemental agreement was made with Kroder in which his participation was to be 20% instead of $33\frac{1}{3}\%$, and it was agreed

Plaintiff's Pre-Trial Exhibit No. 62—(Continued) :

that his 20% was to be divided 10% to Johnson and 10% to Kroder. On August 31, 1944, a formal agreement confirming that set out in the letter of August ninth was executed by Jones and myself with Kroder, and Johnson's interest was again stated to be 10%.

Thereafter certain transactions took place between Kroder and Johnson of which we do not here have any record. They are recited in a document executed by Diana Wallace Scott under date of April 24, 1945, of which copies are enclosed. According to our information, the recitals in that document are correct, and they indicate that Kroder, upon some date not stated, assigned Johnson's 10% interest to him and that subsequently thereto Kroder and Johnson each assigned 1% of his interest to Diana Scott, and thereafter Kroder assigned the remaining 9% of his interest to Diana Scott, and thereafter Diana Scott assigned 5% out of her 11% interest to Walter M. Wells.

From the foregoing it now appears that Johnson now owns a right to receive 9% of the stock of Mina del Refugio, and unless he has in some way transferred or encumbered some part of that 9% interest, he still owns it.

Mr. Jones and I are advised by Mr. Harris that Johnson says that he still owns his 9% interest and that he would like to sell that interest to Mr. Jones and myself for \$4,000. Jones and I are willing to purchase Johnson's 9% for \$4,000 payable in cash

Plaintiff's Pre-Trial Exhibit No. 62—(Continued):

upon the execution of a proper assignment and transfer, and we are also willing, in order to be entirely fair to Johnson, to give him an option to repurchase his interest at any time within twelve months of the transfer for the same amount we paid for it, without interest. The option may also contain the provision that if he desires to repurchase any fractional part of the 9% within such period of a year he may do so upon repaying a corresponding proportion of our purchase price. However, this option for repurchase is personal to Johnson, is to be exercised in his lifetime and is not transferable by assignment, encumbrance or any creditor's proceeding and is not to pass to his heirs, executors, administrators or beneficiaries.

As I told you over the telephone, much of the equipment which we have sent to Mexico for the Tescalama operation will probably not in any way appear on the Pacific Brokerage Company's records. For example, our first substantial shipment was loaded onto a 1½-ton White truck, and this truck-load of stuff was driven to Mexico, via Nogales, by Johnson himself, and it is our understanding that he arranged the crossing into Mexico, which took place under an export permit which we ourselves had obtained from Washington. I assume this entire crossing arrangement was without any intervention by the Pacific Brokerage Company and the total value of the items covered by this shipment exceeded \$10,000, including the White truck

Plaintiff's Pre-Trial Exhibit No. 62—(Continued) :

itself which Johnson drove down to the mines with its load of equipment, all of which is still in use there. Furthermore, we subsequently sent down a Chevrolet station wagon having a value of approximately \$1,500 and this was crossed without the intervention of Pacific Brokerage Company, as were numerous other items which were consigned directly to Johnson at Nogales and as to which he must himself have arranged the crossing.

We understand that on the customs' records in Mexico all of this material probably stands in Johnson's name as the consignee and the presumptive owner. The fact is, of course, that it all belongs to Mina del Refugio and Johnson's function was entirely that of an agent and trustee. I would assume, therefore, that a bill of sale or other document of transfer and release executed by Johnson in which he recites his capacity as solely that of agent and trustee as regards the title of all of this equipment and transfers such legal title or interest as he may have to Mina del Refugio with a general description of the truck, the station wagon, the Sullivan compressor and other major items, with an added catch-all clause referring to every item of materials, equipment and supplies located at our warehouse in Hermosillo or at the Tescalama mining properties would clear the record in this matter so that there would be no legal question as to its ownership by Mina del Refugio. In case you may want a detailed inventory of the items covered by the first shipment

Plaintiff's Pre-Trial Exhibit No. 62—(Continued) :
which was taken by Johnson to Mexico in the White truck in September of 1944, I enclose herewith a copy of the list.

In addition to the first shipment covered by the foregoing list, we have sent a large number of additional items of equipment, materials and supplies from time to time which were all consigned to Arthur E. Johnson in care of Pacific Brokerage Company. As to many of these items the Pacific Brokerage Company arranged the crossing, but as to most of them Johnson arranged the crossing into Mexico himself. Among these items there were many pieces of equipment representing very substantial purchase prices, and these additional sums aggregate in value considerably in excess of \$10,000. They include a large number of automobile and truck tires, hoists, jackhammers, drifters, stopers, drill columns, and other pieces of mine equipment and supplies too numerous to mention. If you should require a detailed inventory of all of these shipments we could, of course, prepare it, but it would represent a considerable task and we hope that you will not find it necessary.

Our prime interest in this matter at the present time, in view of Johnson's precarious state of health, is to make sure that he executes the necessary documents not only to vest in Mina del Refugio all his legal and equitable title in the mining properties, equipment, materials and supplies, but all of his title and interest in any stock in Mina del Refu-

Plaintiff's Pre-Trial Exhibit No. 62—(Continued) :

gio so that our situation may not be complicated by having to deal with the Mexican woman with whom he has been living down there as his common-law wife. We don't know just what rights she may have under the laws of Mexico as a common-law wife; in fact, we do not know but that he may have legalized her status by a formal marriage ceremony under Mexican law. In any event, you will understand that we desire to be protected against any complications arising from this source so far as our operations and properties are concerned down there and particularly so far as Johnson's stock interest in the corporation is concerned.

Please feel free to communicate with us about this matter by collect telephone calls or telegrams if you desire further information or data from us.

With kindest regards, I am

Sincerely yours,

JOHN C. HIGGINS.

JCH:JA

Enclosures

P. S. You will note that the agreement between Johnson and Jones and myself under date of August 31, 1944, not only established his initial interest as 10% and fixes his capacity as our agent and trustee, but also provides for the opening of the account at the Banco Nacional de Mexico in his name as trustee. In the present circumstances it is, of course, highly desirable that this bank account be

Plaintiff's Pre-Trial Exhibit No. 62—(Continued):

transferred to Mina del Refugio. When Johnson becomes available I suggest that you advise the Banco Nacional of our desire to make this change and we will also write them directly in that connection. If you will arrange that the necessary documents for Johnson's signature be sent directly by the bank to you so that they will be available as soon as Johnson is able to come to Nogales or so that they can be sent with the necessary instructions by you to Johnson at Tucson, we will see that the bank gets whatever written authority or instructions as may be necessary in this connection from us. Augustus J. Klamt, our engineer now in charge at the mine, is authorized to draw checks against this account and we will advise the bank that he will be also authorized to draw checks against the account when it is transferred to the name Mina del Refugio. For the present, in addition to whatever documents may be necessary for Johnson to execute concerning the transfer of the account to Mina del Refugio, probably all that will be necessary is to have Johnson clearly acknowledge the fact that he has no interest in any of the funds in this account and no rights concerning it except those of an agent representing the company and Jones and myself.

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 63

March 25, 1946.

Air Mail

Mr. Arthur E. Johnson,
c/o Mr. Victor Verity,
615 Valley National Building,
Tucson, Arizona.

My dear Johnson:

We have just received the executed copy of your assignment of your interest in Tescalama and the Mina del Refugio stock, and I enclose herewith our check for \$4,000 covering the purchase price, in accordance with the contract and your arrangement with Mr. Harris.

We are exceedingly sorry that your illness has proved to be so serious, and we hope that the x-ray and radium treatments may bring you through and restore your health to the point where you may again get back on the job at the mine.

The assignment you executed was signed before our letter of instructions reached Mr. Little and it, therefore, did not contain the reservation to you of the right to redeem this stock. We want to assure you, however, that if you should desire to repurchase your interest at any time within a year from now you may do so upon repaying our purchase price of \$4,000 without interest; or if you should desire to repurchase part but not all of the stock you may do so upon repaying such part of our purchase price from you as may be pro rata to the portion of the stock you desire to repurchase. This

privilege of repurchase is personal to you and cannot be exercised by anyone else through assignment or otherwise.

Please feel free to call upon us to do anything within our power to help you through this difficult experience. We know how greatly worried you must be and we would be glad to do anything possible to be of assistance.

With kindest regards and best wishes, I am

Sincerely yours,

JOHN C. HIGGINS.

cc: C R Jones

D E Harris

JCH:JA

Enclosure

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 64

May 16, 1946.

Dear Walter:

Enclosed herewith please find copy of letter which I have dispatched to Mr. Juan Robinson of Hermosillo in which you will note I have asked him to reply to you direct, requesting that he send me a copy of the letter.

As I told you on the telephone, I believe his mine has merit. He made a trip to New York last November or December to clear up the title on this property, and when a Mexican spends his own money on mining property you may rest assured that he has reason to believe that he will come out all right.

Regarding our own property, we are exploiting another claim called "Ana Estella." To date there is very little progress to report on any volume of tonnage, but the narrow vein which we have uncovered shows very good values. It is quite possible that this might be an extension of the Tescalama vein and could open up considerable tonnages. We probably have less than half a dozen men working on this new vein and the balance of our crews have been engaged in road building, excavation for the mill and working on the water supply for the mill. All materials have been ordered for the mill, and with any luck at all, we should be in production by September 1.

I do not know whether or not the news has reached you that Johnson is ill in Tuscon with cancer of the esophagus. He probably will never be

back on the job. With all due respect to Johnson, it is a much smoother operation and work is progressing better under Mr. Klamt's direction, our engineer, than it ever has before. I am much more enthusiastic over this enterprise than when I saw you in New York in November.

You asked me over the phone whether or not I would be willing to sell my interest in Tescalama. In talking with Mr. Higgins, if your associates would really want to get down and talk business, I believe that we would entertain a proposal, but it would cost \$500,000 for our interest. We bought Johnson's interest when it looked like he was not going to last very long, so that Higgins and I are the only stockholders, other than your New York interests.

This figure mentioned may seem very large, but the ore that we have blocked out, together with our present investment does not make it look so exorbitant.

With kindest personal regards, I am

Sincerely yours,

Mr. Walter M. Wells,
71 Broadway,
New York City,
New York.

[illegible]

FOLD O'

OLD O'

JOURNAL ENTRIES

ACCOUNTS PAYABLE			DATE	ACCOUNTS	GENERAL LEDGER		SHIP LEDGER	
Dr	Cr	Ca			Dr	Cr	Dr	Cr
47,836	406	750677	Aug 3	Disposition House - 1937 Cadillac	178,154.00	150,134.33	13,119.704	
				Automobile	1970.70	1970.70		
				Trucks & Cars				
				U.S. Savings	100,900.00	100,900.00		
				Income from bank - Long Beach		39,152.90		
				Clarking fee - bank Long Beach	600.00			
				Telephone Exp. - "	8,781.00			
				Radio Transmitters - Navy				
				Telephone Exp. - bank Long Beach	548.00			
				Enter Truckers Deck & Ship				
				Salary - D. E. Harris	500.00			
				D. E. Harris -				
				J. Harrington -	12,208.11	6,864.73	13,129.04	
				Amphibious			5370	
				John Hunt			1768	
				House - Vacation Pay -			5370	
				Vacation Reserve - 1/2 House		778.00		
				Vacation House Long Beach		441.48		
				House			20900	
				Set up Payroll -				
				Ship P. Loss - Insurance on 11 1/2% 1945	20,283.75			
				State Industrial Accident Comm		20,283.75		
				Union Paper R.R. Co.				
				Union Paper R.R. Co.	20,283.75			
				Southern Paper Co.				
				Brighton bank - Long Beach -	402,467.60			
47,836.77	39,679.06	250677			178,154.00	150,134.33	13,119.704	

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JOURNAL ENTRIES

No. 6049c⁶¹

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	✓			1138860	1
	60122			650667	2
EW 46703.18	60132	8319536		1859691	3
	60162	1384703		392839	4
63.078.31	60192	1078695		372546	5
80009.44	60222	2235955		607842	6
86345.75	60252	1041063		407432	7
17-75.01	60282	1827715		1492789	8
70607.29	60332	1140748		449520	9
(3088.48)	60372	1210532		11180109	10
7879.94	60412	1471628		324786	11
10,401.44	60442	967863		715713	12
	60472	1041953		904247	13
9874.6	60522	3336856		5502132	14
	✓	987426		26044173	15
		26044173		26044173	16
					17
	✓			987426	18
Q - 6700.35	60522	3175013		2857622	19
ev - 3812.26	6056	1256203		945600	20
		4431296		967474	21
				4812522	22
X. 10,825.40	6059	3142976		5479210	23
h 12034.43	6061	1273818		1152915	24
	64451			275400	25
	6066	36620		2000	26
	6066	15000		7120047	27
	6066A	300			28
	6066B	20000			29
	6068	1237622			30
20635.75	6068	25990			
		9183622			

1946

1	Jan 1	Balance
2	10	Dividend - W. J. Jones & Son, Inc.
3	31	JE 6013a
4	Feb 18	JE 6016a
5	Mar 18	JE 6019a
6	Apr 30	JE 6022a
7	May 31	JE 6025a
8	June 30	JE 6029a
9	July 31	JE 6033a
10	Aug 31	JE 6037a
11	Sept 30	JE 6041a
12	Oct 31	JE 6044a
13	Nov 30	6047a
14	Dec 31	6050a
15		To Balance

1947

18	Jan 1	Balance
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19	Jan 31	
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20	Feb 28	
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21	Mar 31	
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22	Apr 30	
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23	May 31	
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24	Jun 30	
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25	Jul 31	
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26	Aug 31	
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27	Sep 30	
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28	Oct 31	
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29	Nov 30	
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30	Dec 31	
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		1947	forward
1	June	30	
2		30	
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6		30	
7	July	31	
8		31	
9		31	
10		31	
11		31	
12		31	
13		31	
14	Aug	31	
15		31	
16		31	
17		31	
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20		31	
21	Sept	30	
22		30	
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		1947	forward
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		20635.75	
	c 4455		3091.58
	ckR	7372 29	
	6069 P	501.76	
	6069 Q	153 00	
3937.42	6069 A	366 20	2000 00
4637.42	6071 F	700 00	5091.48
	6072	729 00	
	6076	647 55	200 -
	6077	366 20	2000 -
	6077	3 00	
	ck11	2004 08	
	c 4459		10943 18
665.07	6078	150 00	
	4464	32 99 83	12 234 76
	ckR	8017 06	844 57
	6087 E	694	
- 158 82	6085 A	313 62	
	6085 G	41 37 45	1.9 079 33
	6085 G	150 00	
	6085 G	366 20	2000 00
5677 82	6085 G	3 00	
	c 4468	41 75 66	21 079 33
	ckR	12481 90	7280 50
	6088 G	664	
	6089 C	1000 00	
	P.C	150 00	
	6089 L	366 20	2000 00
5404 56	6089 L	3 00	
	4472	55 76 43	30 359 83
	ckR	12654 30	1322 41
	forward		

Analysis of August, 1946 Entries to Account of Clayton R. Jones

	Dr.	Cr.
L. D. phone calls	\$ 14.49	
United Air Lines	85.68	
Withheld Income Tax on salary	366.20	
Oregon Physicians Service	2.50	
Property Rent	150.00	
Cash Advances—Misc.	1,986.45	
Cash Advances for deposit to Jones & Higgins acct.	9,500.00	
Salary—W. J. Jones & Son		2,000.00
Salary—Rothschild-International Stevedoring Co.		495.00
Salary—West Oregon Terminals		1,000.00
Repairs to property owned by W. J. Jones & Son		261.11
Entertainment expense for W. J. Jones & Son		300.00
Travel expense for W. J. Jones & Son		147.55
Auto damage expense for W. J. Jones & Son		11.70
Mina del Refugio Notes assigned to W. J. Jones & Son		102,930.96
Mina del Refugio Interest assigned to W. J. Jones & Son		4,654.57
Totals as of August 31, 1946.....	<u>\$12,105.32</u>	<u>\$111,801.09</u>

Analysis of December, 1946 Entries to Account of Clayton R. Jones

United Air Lines	9.62	
Northwest Air Lines	272.10	
L. D. phone calls	24.90	
Withheld Income Tax on salary	366.20	
Property rent	150.00	
Oregon Physicians Service	2.50	
Cash Advances—Misc.	27,543.24	
Cash Advances for deposit to Jones & Higgins account	5,000.00	
Salary—W. J. Jones & Son		2,000.00
Salary—Rothschild-International Stevedoring Co.		495.20
Salary—Sumpter Valley Dredging Co.		916.80
Salary—West Oregon Terminals		1,000.00
Insurance dividend		214.04
Linnton Terminals partnership profits		1,500.00
West Oregon Terminals partnership profits..		1,500.00
Interest on U. S. Treasury Bonds		3,562.50
Cash Advance reimbursement		25,000.00
Mina del Refugio Notes assigned to W. J. Jones & Son		18,832.78
Totals as of December 31, 1946	<u>\$33,368.56</u>	<u>\$ 55,021.32</u>

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 68

April 4, 1947.

Mr. Walter M. Wells,
c/o Isthmian Steamship Co.,
71 Broadway,
New York, N. Y.

Dear Walter:

I returned from the mine a week ago today and upon my arrival I cashed the first six bricks from the mine, which amounted to about \$7,000 American.

I enclosed herewith snapshots which I took of the six bricks and the mill. The mill was shutdown when I got there on account of some worn out parts, and I do not expect it will get started before next week.

The mill is gradually getting shaken down, but it has been a much longer process than would normally occur in the states. Things just don't move fast down there due to the remote location and the poor communication system. We are installing a radio-telephone at the mine and one at Hermosillo which will facilitate a lot of delays. The mine itself looks as good as it ever did.

Best regards.

Sincerely yours,

CLAYTON R. JONES.

CRJ:KJ

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 69

1030 Public Service Bldg.

August 4, 1947.

Mr. Juan F. Robinson,
House 144,
Calle Hidalgo,
Hermosillo, Sonora,
Mexico.

Dear Mr. Robinson:

I have telegraphed you today as follows:

We Are Ready to Make Final Payment For Properties Under Our Contract With You. We Assume You Will Want Mr. Little at Nogales to Handle Final Transaction and Prepare Necessary Papers. Please Wire Us Immediately at 1303 Public Service Building Portland, Oregon, Whether You can Be in Little's Office in Nogales to Receive Final Payment and Execute Final Deed on Monday, August Eleventh. If So, Please Advise Mr. Little Immediately and Also Procure and Take With You to Nogales Necessary Power of Attorney for Jorge and Ana to Execute Deed for Them. Please Also Wire Us Your Calculation Amount of Final Payment Due You After Royalty Deduction.

We assume that the arrangement for the final closing of our purchase transaction with you at Mr. Little's office in Nogales will be satisfactory to you, and upon hearing from you by telegram to

that effect we will transmit the money to the Valley National Bank at Nogales so that the payment can be made to you upon the execution of the final papers.

We discussed this matter over the telephone with Mr. Little today and he advised us that he would be prepared to meet you at his office at Nogales on next Monday, August 11th, to handle this transaction in your behalf and ours. We both have confidence in him and since he has acted as attorney in this matter throughout and is familiar with all details of the transaction and thoroughly competent to protect both your interest and ours in the preparation of the necessary documents, we feel sure you will approve this method of handling the matter.

Since the final deed must bear the authorized signatures of Jorge and Ana as well as yours, Mr. Little suggested that you should be sure to procure and take with you to Nogales the necessary power of attorney executed by Jorge and Ana empowering you to execute the deed for them.

It is our understanding that since the original contract was made with you some additional mining claim locations or denouncements have been made by you or Jorge in our behalf which are to be included in the final deed to us. If we are correct in this understanding, please be sure to take with you to Nogales all necessary information and descriptions of this additional ground so that it may be included in the deed to be prepared by Mr. Little.

With assurances of our kindest regards and our appreciation of your uniform courtesy and cooperation in our transactions with you, I am

Sincerely yours,

JOHN C. HIGGINS.

JCH:JA

Airmail

CC to Mr. Clayton R. Jones

CC to Mr. Malcolm C. Little

CC to Mr. E. C. Smith

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 70

Mina Del Refugio, S. A.

January 15th, 1948.

Mr. John C. Higgins,
1303 Public Service Bldg.,
Portland 4, Oregon.

Dear Mr. Higgins:

Enclosed is a copy of my telegram heartily approving your arrangement with Paul Avery, who was a classmate of mine at Stanford. He is well known and has a fine reputation among mining men in Mexico. After all this hectic make-believe efficiency and doctoring tonnages and mill sampling to suit the supervisor for high rates of recovery at the expense of proper weights and head samples, it will be a relief to have competent supervision by a technically trained chemist and mill operator.

As our rich ore has already been put through the mill it becomes necessary to expenses at all points if we are now to continue milling our lower grade ores without the sweetening for uniform grading which we had counted on from the 200-level ore body. By eliminating Ramsden and turning his duties over to a day-shift boss we can probably save 1500 pesos monthly and by further trimming down the mill crew we hope to make a fair saving.

Our good Tescalama ore shoot was much shorter on the 260-level and definitely quit on its northerly course at the beginning of the caverns on the same level 168 ft. north of the winze. On its downward course the ore also quit, reaching its deepest point only 20 ft. below this level. Our most northerly winze, now used for transferring ore from the lower levels up to the 153-level, was continued to the 300-level, the vein changing from ore to gouge and, near the 300-level, to 26 inches of pure coal.

As the distance at present between the end of the Tescalama 260-level and the Ana Estela Tunnel level is now about 500 ft. with a difference in elevation of about 165 ft., this unexplored area seems to offer the best chance for finding more ore because the Ana Estela and Tescalama are quite definitely the same vein. It is also quite probable that the Oro Grueso Tunnel is on this vein.

Since our Ana Estela Incline Shaft at its present bottom is still in a strong gougy vein with non-commercial values, present slope depth about 115 ft., we are checking its prospective phases either

for deepening it or running a shaft drift south at this depth to see if we may pick up an extension of the ore that quit above this level. We also have in mind the sinking of this shaft to a depth necessary to make the connection with the 260-level of the Tescalama by drifting south. As no other vein outcrops have been found below this vein system we believe that it is best to confine our major work on it.

We are also doing some sampling in the old Candelero Mine which Juan Robinson and Sr. Rendon, owners, have invited us to test.

We gladly look forward to Paul Avery's arrival.

Yours very truly,

/s/ A. J. KLAMT.

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 71

March 9, 1948.

Personal

Mr. Walter M. Wells

c/o Isthmian Steamship Co.

71 Broadway

New York, N. Y.

Dear Walter:

I returned from Mexico and California about ten days ago and immediately came down with an attack of influenza and have just about recovered from same. I finally secured the Profit and Loss Statement, together with financial statements of the company yesterday and I am hastening to forward

it on to you. All in all, this company is a very sorry picture.

After taking our depreciation, depletion and organization expenses, there was a loss last year of a little over \$20,000. I would not be so disturbed about this loss as we had a terrific year due to breakdowns and the ordinary troubles starting up a new mill, but what does make our picture look black is that they have discovered no new ore bodies, with the exception of one on which we are now working, in over a year. When we blocked out this ore, Mr. Klamt, our engineer, took what is known as an "Engineer's License" and projected the ore past the known limits. His estimation and calculations both as to ore reserves and ore recoveries fell down at least 60%.

I smelled a rat in his letters which started to come in about the first of the year and, although there was nothing definite, I went down immediately and found out what I had suspected, that we were using up our ore with no new ore to take its place. This long distance management is a very difficult situation and, although I do not believe Mr. Klamt willfully led us astray, his judgment was very, very bad.

At the present time I believe that we can run about a year on the known ore that we have, but unless they turn up with some new ore bodies this project is going to be a colossal failure. I had no idea of this situation until shortly after the first of the year. We have had innumerable troubles getting out a financial statement due to the translation

of our Mexican bookkeepers into American phraseology, plus the fact of the necessary delays in sending data from the mine to our Hermosillo office and then on to Portland.

I am planning to leave again for the mine in about a week or ten days to see at first hand what they are doing on some exploitation work which I outlined while I was there. We are pumping an old mine which is full of water, which we purchased at the time we bought our present property, and are going to explore that in the hopes that we can uncover some new ore. You will be hearing from me about this later.

I saw Alice and George Lilly in San Francisco and thought George looked a little tired. I think this trip to Honolulu is going to be a fine vacation for him and should do him a lot of good. I plan to be in New York sometime before summer, but do not have any definite plans at the present time.

I trust that the enclosed information will not be too great a shock to you, but it certainly was a bad one for me when I first suspected what was taking place.

With kindest personal regards, I am

Sincerely yours,

CLAYTON R. JONES.

CRJ:KJ

Enclosure

Airmail

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 72

Mina del Refugio, S. A.

April 1st, 1948.

Mina del Refugio,
Portland, Oregon.

Dear Sirs,

Liquidation No. 25

We are this morning melting the clean-up of mill-run from March 16th to March 31st. The numbers of these bars will begin with No. 100. It will probably be a week before we receive first payment.

Prior Liquidations

No. 24: Bar #98 was recovered from the washings from precipitation bags. Bar #99 was the result of melting the remainder of the scrapings from the shell of the ballmill, the first part of which was made into Bar No. 94.

The status of order of bullion payments received to date:

Pesos

Most recent 1st or down payment (Adelantos), Mar. 24th, Liq. #24.....	5,925.38
Most recent 2nd or Official Assay Adjustm't, Mar. 18th, Liq. #22.....	9,057.57
Most recent 3rd or balance after silver tax, Mar. 18th, Liq. #16.....	15.90

The checking of the ultimate settlements with exactitude is a tedious job and can be done only in absence of more pressing work. In past completed

Plaintiff's Pre-Trial Exhibit No. 72—(Continued) :

settlements the calculations appear to have been done quite thoroughly. The months of waiting for their determination of the exact metal price and applicable tax rate delays the precise checking of the completed settlements. Their injected complications absorb time.

The six bars of varying sizes, Nos. 100-01-02-03-04-05, forming Liq. No. 25, promise very good weight and quality, from present appearance while being cast.

Exploration

We are naming the flat vein development above the 153-level as developed in all of our footwall crosscuts from No. 1 to No. 8 as the "115- Level North." In elevation this corresponds to the old 115-level south of the main haulage shaft.

We at first began this work on the most meager indications by noting carefully any fugitive stringers of quartz entering the footwall of our vein drifts, then driving footwall crosscuts and on their resulting indications, driving raises on the stringers. The results were very pleasing, confirming a ladder-like vein structure expressed in our early examinations and likewise compensating by outward bulging ore extensions for the inward bulging waste masses of our straightline ore blocks used in forming our ore estimates at a time before we had the raises and winzes necessary properly to delineate the sinuous form of any orebody.

As some of our mainway levels in the Tescalama

Plaintiff's Pre-Trial Exhibit No. 72—(Continued):
 and Ana Estela have already passed out of the course of the known oreshoots at points where there are vague signs of transposition we believe it the least expensive, most direct and promising method to apply the crosscut and raise method from existing level extensions for picking up possible vein transpositions. This is the plan we are using.

Liq. #25 (Continued)

As Bars Nos. 100 to 105, inclusively, have just been weighed, and in our assayer's task of giving us their fineness, their weight only can at present be given, as follows:

Bar No. 100	33.5 kilos
Bar No. 101	23.5 kilos
Bar No. 102	24.0 kilos
Bar No. 103	30.0 kilos
Bar No. 104	37.0 kilos
Bar No. 105	5.2 kilos
	<hr/>
	153.2 kilos

The assays will be ready later this afternoon and the bars will be in the Banco de Mexico tomorrow morning.

Exploration (Continued)

In the Ana Estela we have 10 men, all being on production. As we are keeping our Tescalama crew alternating week by week from production to exploration we are at present keeping the small crew on the Ana Estela on straight production, which often leads to other obscured orebodies in the por-

Plaintiff's Pre-Trial Exhibit No. 72—(Continued):

phyry formation. The ore in the Ana Estela is nearly entirely in the porphyry, while that in the deeper Tescalama is usually in the replaced coal seam in the shale formation.

Mill Operation

This is going ahead steadily and smoothly. All jealousies, contentions and confusion—and excessive expenses—seem to have vanished with the exit of Ramsden. All hands work together without friction as they should in an organization.

About two-thirds of the ore is coming from the Tescalama and the rest from the Ana Estela.

Your daily mill reports will furnish the details of the mill operation.

Water Supply

Because of the continued drouth I yesterday inspected the supply at the Arrellanas and found that it is maintaining its flow without any threatening decrease. We are pumping steadily at rate of 10 gallons per minute and leaving the intake dam overflowing at about 4 gallons per minute.

While replacing the head gasket and grinding the valves on the Waukashe gasoline motor we pumped from the Goteras two days.

Please have the Waukashe agent furnish us promptly the parts catalogue for this motor. Its identity is Model ICK 5110V-No. 89476. We shall appreciate the pamphlet or booklet giving a more

Plaintiff's Pre-Trial Exhibit No. 72—(Continued):
complete description of its possible performance.
We wired your office for two sets of gaskets for this
motor.

Yours very truly,

/s/ A. J. KLAMT.

Mr. Avery on Carbonaceous Ores

As I had asked Mr. Avery to make some mention of the effect of the carbonaceous shale and carbon contents, coal, graphite, etc., in the ores, I find that his reports do not make any reference to this subject. However, I discussed this matter with him and he replied that his tests showed no appreciable harm to the metallurgy from these carbon contents and that they probably were comparatively ineffective in precipitating any measurable values from the pregnant solutions. This answer was quite reassuring to me because most of the ores in the Tescalama carry some kind of combined carbons, presumably too tightly fixed in their molecular combinations to be released in the alkaline cyanide solutions. Therefore he left me with the impression that in his opinion the various carbonaceous materials in the ores are almost harmless in our milling process.

Noche Bueno Operation

Although pumping steadily at the rate of 35 gallons per minute, 24 hours daily, the lowering of the water during the past two weeks seems to have gone

Plaintiff's Pre-Trial Exhibit No. 72—(Continued):
down only about one inch per day. In about an hour of pump stoppage for servicing the water rose quickly several inches.

This makes it appear that some greater source of inflowing water with a water table about 70 feet below the surface collar of the shaft exists. This makes our efforts with the 35-gallon capacity pump look like an unsuccessful task. Therefore, we may have to go in for a larger pumping installation. However, I shall make some more conclusive observations before making any definite recommendation.

As we are using the Goteras equipment for this Noche Bueno dewatering, it leaves us without a ready water supply in case something should happen to our Arrellanas plant, although we try always to have about two days' water supply in our storage tanks at the mill.

In case we should find it necessary to restore the pump to the Goteras, would this have your approval?

Yours very truly,

.....,

A. J. Klamt.

Mr. Sanchez is doing very well and is a splendid cooperator. We are trying to reduce mill expenses and increase efficiency wherever possible.

/s/ A. J. K.

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 73

April 8, 1948.

Mr. A. J. Klamt,
Mina Del Refugio, S. A.,
Apartado 22,
Hermosillo, Sonora,
Mexico.

Dear Mr. Klamt:

I wish to acknowledge your letter of April 1st. I take it from your paragraph under the heading "Exploration," that you have not had any success in discovering any new ore bodies on the Crosscut No. 9 on the 153 Level, or any new on the 115 Level North, which you were calling Crosscut No. 8 while I was there. Please keep us fully advised each week on your exploration activities.

I was indeed disappointed to learn that your pumping operation is already lowering the Noche Bueno operation one inch per day. Did you get down to the first level, which was showing up when I was there? We want you to keep us advised in detail of your operations in this shaft as we are pinning a lot of hope of finding new ore in this old mine.

You ask us the very obvious question as to whether or not we would approve restoring the pump to Goteras in case it is necessary. This is a very obvious question as we must keep the mill operating and we cannot do so without a water supply. I cannot understand your evidently disturbed thoughts regarding the Arrelanas water after we went through such a dry summer as last year.

Our instructions to you are to keep pumping on Noche Bueno until it seems like a fruitless operation. If you will remember, Goteras at one point of our pumping only went down a little bit and then it dried up very quickly. Maybe we will find a similar condition in Noche Bueno.

Please keep us advised weekly as requested by me on my last visit.

Your very truly,

CLAYTON R. JONES.

CRJ:KJ

cc: J. C. Higgins

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 74

Telegram

Western Union

W. J. Jones & Son, Inc.

November 15, 1948.

Mr. A. J. Klamt,
Mina del Refugio,
Corner Calle Iturbide Yavenida Yucatan,
Hermosillo, Sonora,
Mexico.

Higgins and I Request You Commence Dismantling Mill Immediately Transporting All Supplies and Materials to Our Corral in Hermosillo. Your Instructions Are to List Each Truckload in Detail Leaving Mine and Have Smith Check in Detail and Receipt Advising Portland Office of Quantities

Shipped Each Week. We Desire You Salvage All Possible Materials Especially Lumber for Resale at Hermosillo. We Suggest You Bring Pipe in First and Advertise Quantity and Sizes in Hermosillo Paper. You Will Telegraph Offers to Portland for Confirmation.

CLAYTON R. JONES.

CRJ:KJ

cc: Mr. J. C. Higgins

4:50 p.m.

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 75

December 27, 1948.

Airmail

Mr. A. J. Klamt,
10601 Wilkins Avenue,
Los Angeles 24, Cal., and
841 Iturbide,
Hermosillo, Sonora, Mexico.

Dear Gus:

I enclose herewith 2 copies of the Agreement as discussed with you over the telephone today. Please sign the original ribbon copy on the blank line for acceptance and confirmation and airmail it back to me. I am also airmailing 2 copies to you at Hermosillo in case you miss the ones addressed to you at Los Angeles, and if so, please sign and return by airmail one of the tissue copies.

You are authorized to make such arrangements

Plaintiff's Pre-Trial Exhibit No. 75—(Continued):

with employees, as to their wages, tenure and working conditions as you may determine to be necessary or expedient, for the period commencing with Jan. 1, 1949, since they will then and thereafter be your personal employees and not the employees of the company. If you should determine that any of the persons heretofore employed by the company are to participate with you, on a profit-sharing basis or otherwise, in this contract, and if you should not be able to make a mutually satisfactory arrangement with any one or more of them, and if you should desire that we act as mediators to settle such disagreement, we shall be glad to do so, but there is no obligation on your part to submit such a disagreement to us, since under the terms of our contract with you in this matter, it is within your right and power to make such arrangements with them as you may decide.

Yours very truly,

JOHN C. HIGGINS.

JCH:lu

Copy of this letter
and the Agreement to
Mr. C. R. Jones.

Plaintiff's Pre-Trial Exhibit No. 75—(Continued):

Mina Del Refugio, S. A.

December 27, 1948.

Airmail

Mr. A. J. Klamt,
841 Iturbide—and
10601 Wilkins Avenue,
Los Angeles 24, California.

Dear Gus:

This will confirm the agreement Jones and I, as officers and directors of Mina del Refugio, S. A., made with you over the telephone today concerning the dismantling of the mill, the transportation of the mining and milling equipment and supplies to Hermosillo, the payment of the costs involved, the sale of the equipment and supplies and the disposition of the proceeds therefrom, which agreement is as follows:

1. It is agreed that you are to be in full and complete charge of the foregoing proceedings, at the Mexican end, subject only to the conditions and limitations hereinafter stated.

2. You are to complete the dismantling of the mill and the transportation of all mill, mining and other equipment, materials and supplies to the corral in Hermosillo as promptly as possible, except in cases where purchasers may take delivery at the mine.

3. By December 31, 1948, if possible, or as soon

Plaintiff's Pre-Trial Exhibit No. 75—(Continued):

thereafter as it can be accomplished, you are to pay from the company's funds on hand, or in bank, all of the Company's outstanding accounts, pay rolls and liabilities, and you are to transmit to the Valley National Bank, the full balance of any funds then on hand in Hermosillo for deposit in the account of Mina del Refugio, S. A., except that you may retain, as a revolving fund, in the bank at Hermosillo, a balance of \$5,000 pesos, or its equivalent in United States currency, for your convenience in meeting local expenses involved in the dismantling, shipping, handling and sale of the equipment, materials and supplies. This revolving fund is to be charged to you personally, and is to be accounted for to us as an addition to the \$20,000 net to be paid to us from the proceeds of the sale of the equipment, materials and supplies, as stated below.

4. All costs, charges and expenses incurred or accruing on or after Jan. 1, 1949, arising out of or connected with the care, handling and disposition of the company's properties, equipment, materials and supplies in Mexico, are to be charged to your account. This includes, among other things, all costs and expenses involved in the dismantling of the mill and other equipment, the transportation thereof to Hermosillo, or elsewhere, the storage thereof in Hermosillo, or elsewhere, the sale, delivery or other disposition thereof to others, all pay roll charges incurred or accruing on and after Jan. 1, 1949, and all rentals on the corral or insurance or other charges on the equipment, materials and supplies.

Plaintiff's Pre-Trial Exhibit No. 75—(Continued):

5. You are to make full and detailed weekly reports to us of your progress in these matters. Such reports shall cover, among other things, the following:

(a) Progress in dismantling the mill and transporting the equipment to Hermosillo.

(b) All sales actually consummated, covering the items sold and the amounts received.

(c) The disposition of all cash received, whether deposited in Hermosillo or the Valley National Bank at Nogales.

(d) All other matters substantially affecting the progress you are making in disposing of these assets, including such offers as you may receive from prospective purchasers, or such offers of sale as you may make on items of equipment, materials and supplies, in instances where the purchase or sale price amounts to \$500 or more. Since we are interested in the result of your sales, to the extent of seeing that the net proceeds finally available to the company, or to us as its principal creditors, amount to \$20,000, we reserve the right to reject or confirm, before consummation of any sale, offers of sale or purchase where the amount involved in the proposed transaction, equals or exceeds \$500.00. Of course, it is not practicable for us from here at this time to define more closely the proposed offers of purchase or offers of sale which are to be submitted to us before consummation, except by the general definition just stated as to amount involved, but there

Plaintiff's Pre-Trial Exhibit No. 75—(Continued):

is to be included in this category every proposed sale where the original cost to the company of the items involved in any proposed sale amounted to \$500 or more.

6. It is agreed that you are to pay to us, as trustees for the company, the first \$20,000 received by you on account of such sales and that you are to retain all proceeds of such sales exceeding that total amount. From the amount you so retain, you are to pay all your costs and expenses in this regard, incurred or accruing on and after Jan. 1, 1949, and the balance will be your compensation for your time and efforts devoted to this matter, on and after Jan. 1, 1949.

7. The proceeds of all sales, up to a total of \$20,000 are to be remitted as soon as received by you, to the Valley National Bank at Nogales, Arizona, for deposit in that Bank to the joint account of Clayton R. Jones and John C. Higgins, trustees, and after such remittances have reached the total sum of \$20,000 you need thereafter make no further remittances, and no reports of offers, sales or progress, since the balance of the proceeds will belong to you. There will be credited against the required total of \$20,000 to be remitted to the Valley National Bank, the \$5,000 you deposited in that Bank on December 21st, as reported in your telegram of Dec. 22nd.

8. It is, of course, understood that any amounts

Plaintiff's Pre-Trial Exhibit No. 75—(Continued):
which have been heretofore received or may hereafter be received on account of bullion payments, tax refunds or from any other sources except the proceeds of sales of equipment, materials and supplies, are entirely outside the terms of the contract with you as stated and that no such sums are to be credited or applied in reduction of the \$20,000 net payment to us hereinabove mentioned.

Yours very truly,

/s/ JOHN C. HIGGINS.

Accepted and Confirmed:

/s/ A. J. KLAMT.

PLAINTIFF'S PRE-TRIAL EXHIBIT No. 76
Minutes of Special Meeting of Board of Directors
of
Mina Del Refugio, S. A.

A Special Meeting of the Board of Directors of Mina del Refugio, S. A., was held at 10 o'clock a.m. on December 27, 1948, at 1303 Public Service Building, Portland, Oregon.

Present were John C. Higgins and Clayton R. Jones, constituting a quorum for the transaction of business.

Mr. Higgins acted as chairman and Mr. Jones acted as secretary.

Mr. Higgins and Mr. Jones discussed the hopeless

Plaintiff's Pre-Trial Exhibit No. 76—(Continued):

plight into which the affairs of the Company had recently fallen. Mr. Higgins and Mr. Jones reviewed the reports of the Company's engineer, A. J. Klamt. Mr. Jones substantiated the conclusions in said reports from his personal observations made during his visits to the site of the mining operations in 1948, and particularly his last visit there, in November of 1948. On the basis of said reports and observations, which definitely established the exhaustion of all available ore capable of being mined with any hope of meeting operating expenses from the properties now owned and held under lease and option by the Company, and the failure of all plans to find other promising mining properties or to continue or resume milling operations on gambisino ore, Mr. Jones and Mr. Higgins agreed that the company's mining and milling enterprise should immediately be ended and abandoned, that its saleable assets should be sold, the proceeds distributed to its creditors, its affairs should be wound up and the company should be dissolved.

Mr. Higgins and Mr. Jones then discussed the progress which had been made in dismantling the mill and mine equipment pursuant to their previous decision in the latter part of 1948 to curtail operations. Mr. Higgins submitted a copy of an agreement which he had prepared on behalf of the corporation providing for the sale to Mr. A. J. Klamt of all the structures, fixtures, equipment, and

Plaintiff's Pre-Trial Exhibit No. 76—(Continued):
supplies connected with the mining operations of the Company.

Upon motion duly made and seconded, the following resolution was unanimously adopted:

Resolved, That the agreement confirmed in a letter dated December 27, 1948, from John C. Higgins to A. J. Klamt, a copy of which is ordered to be attached to the minutes of this meeting, be and hereby is approved and adopted by the Directors of the Company, and all acts of Mr. Higgins and Mr. Jones as officers and directors of the Company in entering into said agreement, and all acts of said persons in carrying out said agreement and in taking all steps necessary and proper for the cessation and abandonment of all operations of the company be and hereby are ratified and approved by the Board of Directors.

Mr. Higgins pointed out that the most that could be realized by the Company under said agreement was \$20,000, plus any additional portion of the Company's funds referred to in paragraph 3 of the agreement remaining after payment of the Company's outstanding liabilities. He stated that at most this additional sum, over and above the \$20,000, might amount to as much as \$2,500. He stated that there was no possibility that any sum over \$2,500 would be realized from this source and that the actual amount thus realized would probably be less than \$1,000. He also stated that, in his opinion,

Plaintiff's Pre-Trial Exhibit No. 76—(Continued):

it was very doubtful whether even as much as \$20,000 would be realized by the Company from the sale of the equipment, structures and supplies. It was also explained by Mr. Higgins that paragraph 8 of said agreement was inserted as a precautionary measure and that the Company did not anticipate the receipt of any money after December 31, 1948, on account of bullion payments, tax refunds or from other sources.

Mr. Jones observed that said agreement disposed of all the assets of the corporation with the exception of the real property and mining claims owned by or under lease and option to the Company. Mr. Higgins and Mr. Jones agreed that the real property and mining claims were totally worthless. They were useless to the Company and could not be sold, since such properties have no value because of the exhaustion of all commercial ore deposits. Mr. Jones mentioned that the mine was flooded with water due to the cessation of pumping operations.

Upon motion duly made and seconded the following resolution was unanimously passed:

Resolved, that all real property and mining claims and all interests therein owned or held by the Company be and hereby are deemed to be worthless and the officers of the Company be and hereby are authorized and directed to abandon said property.

Mr. Higgins stated that there remained the question of what distribution should be made of the

Plaintiff's Pre-Trial Exhibit No. 76—(Continued) :

funds of the Company to be realized by the Company under the agreement with Mr. Klamt, plus any funds in the bank account of the Company referred to in paragraph 3 of said agreement. It was pointed out that there were outstanding notes of the Company, and obligations for advances and equipment sales to it in the aggregate amount of more than \$300,000 which had been issued and incurred to evidence the obligation of the Company to repay the loans and advances, and for sales of equipment made from time to time by Mr. Higgins, Mr. Jones, and Mr. Dennison Harris and his family. Mr. Higgins expressed his regret that it was necessary to so bitterly disappoint the high expectations of full repayment for these loans, advances and sales, but stated that the most the Company could possibly pay on said notes and other obligations was a pro rated distribution of the above-mentioned sums which could not exceed \$22,500. Upon motion duly made and seconded the following resolution was unanimously passed:

Resolved, that the officers of the Company be and hereby are authorized and directed to make a pro rata distribution to the holders of the outstanding notes and other obligations of the Company of any and all funds of the Company realized under the agreement with Mr. Klamt confirmed in the letter from Mr. Higgins to Mr. Klamt dated December 27, 1948, plus any funds of the Company on deposit in its

Plaintiff's Pre-Trial Exhibit No. 76—(Continued):

bank account after payment of all prior liabilities.

Mr. Higgins stated that the notes and other obligations of the Company, above mentioned, were obviously more than sufficient to exhaust all the assets of the Company so there was no need to make any provision for the stockholders of the Company since said stock under the circumstances was totally worthless.

Mr. Higgins and Mr. Jones then considered what disposition should be made of the corporate structure of the Company which would be nothing more than a hollow shell after December 31, 1948. Mr. Higgins and Mr. Jones determined that they were not sufficiently familiar with Mexican law to decide whether it would be most expeditious to dissolve the Company, or merely to abandon the corporate structure.

Upon motion duly made and seconded, the following resolution was unanimously passed:

Resolved that the officers of the Company be and hereby are directed and authorized to make whatever disposition of the corporate structure of the Company that they deem most advisable, such authority to include dissolution of the Company or abandonment of the corporate structure.

Plaintiff's Pre-Trial Exhibit No. 76—(Continued):

There being no further business, the meeting was adjourned.

/s/ JOHN C. HIGGINS.

.....,

Clayton R. Jones.

The undersigned, a director of Mina del Refugio, S. A., has read the foregoing minutes of a Special Meeting of the Board of Directors of the Company held on December 27, 1948. The undersigned hereby waives any and all notice required by law for the time, place and purpose of said meeting and hereby ratifies, approves and confirms all action taken at said meeting.

Dated as of December 27, 1948.

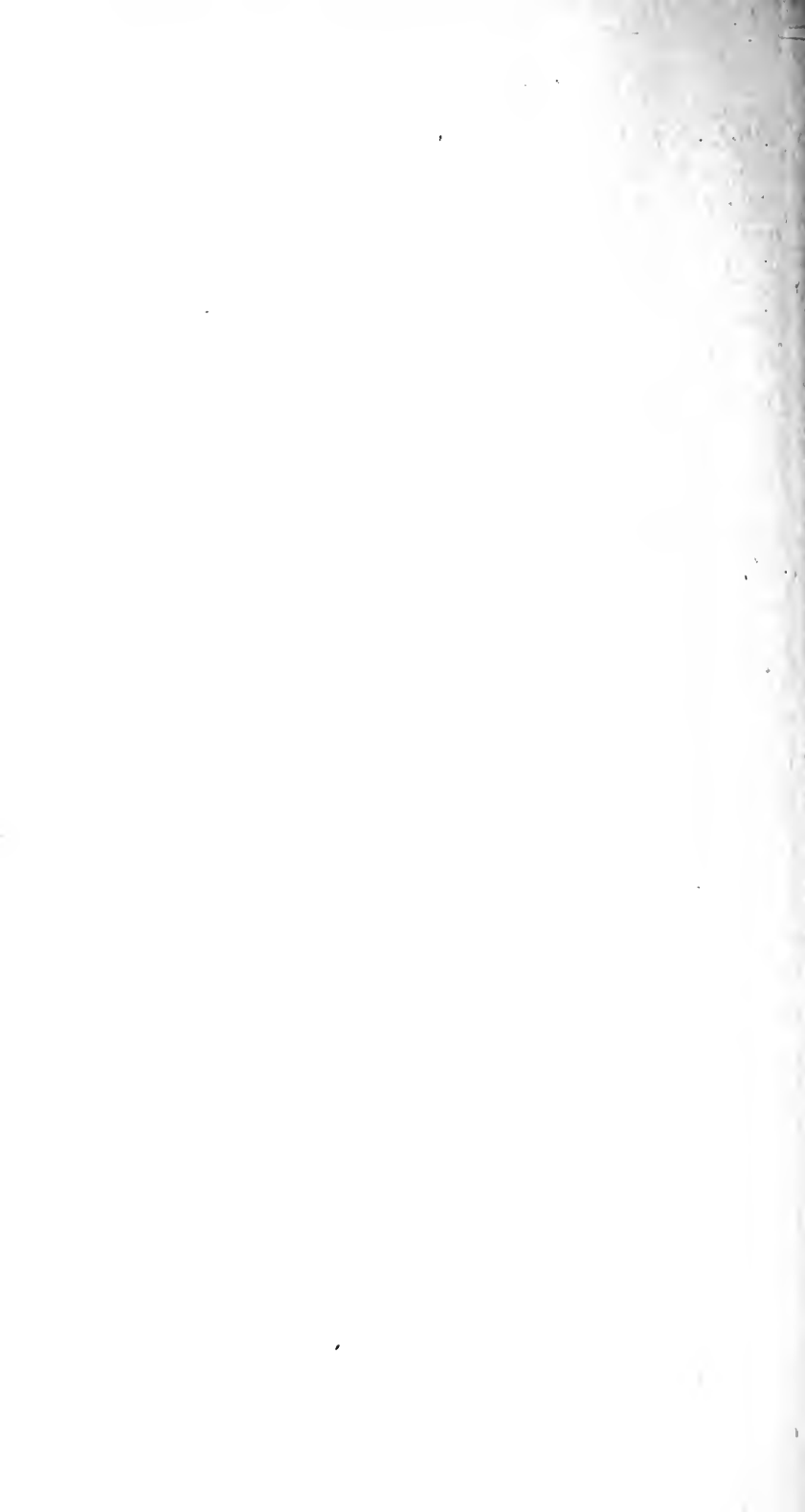
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PLAINTIFF'S PRE-TRIAL EXHIBIT No. 77

I, A. J. Klamt, am a qualified mining engineer, and have been associated with Mina del Refugio, S. A., since the commencement of its activities in connection with the development and operation of its mining ventures in Mexico, namely from 1944 to the present. During the major portion of such time I have carried on the active management of the Company in Mexico. I was and am of the opinion that original surveys for the mining activities, preparation for same, and the early operations of the mine were such as to justify all expectations that the venture would be a most profitable one and that the profits from the venture would greatly exceed any and all of its liabilities. After the mine had been in operation for more than three years, and particularly during the late fall of 1948, it became apparent that the commercial ore deposits had been exhausted and that the venture could not be continued with any hope of meeting operating expenses, much less of making a profit. I have read a copy, attached hereto, of the minutes of a special meeting of the board of directors of the Company held on December 27, 1948, and hereby certify that the action taken by the board of directors at said meeting is in all respects justified and reasonable from a mining and engineering viewpoint.

Dated as of December 27, 1948.

/s/ A. J. KLAMT.





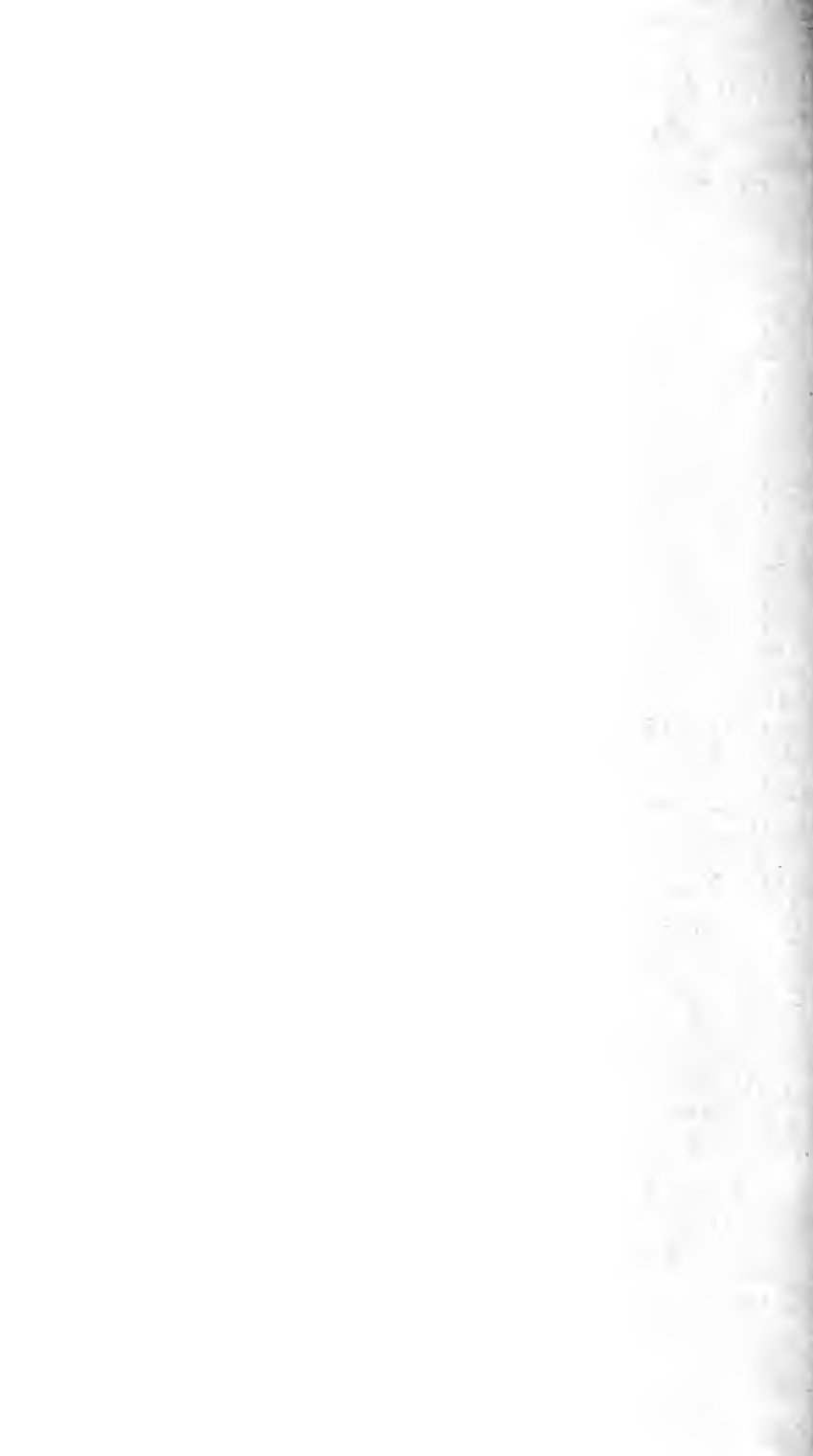


PLAINTIFFS
DEFENDENTS
PRE-TRIAL
EXHIBIT 71
Case No. 75-9
JORN - ARK WITH
Supporting A



JOURNAL ENTRIES

ACCOUNTS PAYABLE		ACCOUNTS RECEIVABLE		DATE	ACCOUNTS		GENERAL LEDGER		SHIP LEDGER	
Dr.	Cr.	Dr.	Cr.				Dr.	Cr.	Dr.	Cr.
200 ✓				1928	Ship's A/c out - ^{camel} boat ^{transporting}	✓	200			
200 ✓					Advertising - Pacific Shipper - Mrs	✓	1500			
1500 ✓					Pacific Shipper -					
650					Legal Expense - H. B. O. Mr. L. McIntire	✓	650			
16300 ✓					Walker, Buckell, O. Mr. L. -		15000			
19648 83										
					O. C. & P. Coal Sale - Storage				1306739 ✓	
					" " - Sharfage -				59156 ✓	
					" " - Labor - ^{hunker crew}				2475 ✓	
					" " - ^{longy} longy ^{spare} spare				60657 ✓	
					" " - Equip & ^{rent} rent				42408 ✓	
1476426 ✓					The Commission of Public Docks.					
					O. C. & P. Coal Sale - Coal -				3647999 ✓	
					Portland Coal Inventory	✓	3647999			
					O. C. & P. Coal Sale - Freight				4009418 ✓	
					Portland Coal Freight Inventory	✓	4009418			
					O. C. & P. Coal Sale - ^{Revenue} Revenue ^{for coal} for coal				1440824 ✓	
					Revenue for Coal Storage	✓	1440824			
1277466 ✓					Commission of Public Docks - ^{Revenue} Revenue ^{for coal} for coal					
					Revenue Storage on Coal on Hand	✓	1277466			
					O. C. & P. Coal Sale - ^{Insurance} Insurance ^{on bunker coal} on bunker coal				56922 ✓	
					Insurance on bunker Coal - ^{Transport} Transport	✓	56922			
					Coal Loading					
2157792 ✓		1200		19	Coal Loading	✓	6321974		6321974 ✓	
						6321974	7919574	7916973	6321974	
					Bad Debt -	✓	14333021			
					Notes Receivable	✓		12176374		
					Interest Receivable	✓		2156647		
					Charging off the bad debt, ^{and} and ^{out} out					
					Minor del. ^{Refugee} Refugee ^{Notes} Notes					
					and their accrued interest 12/31/28					
2157792 ✓		1360		19			21114027	22252595	9616973	6321974



DEFENDANT'S EXHIBIT No. 80

Treasury Department
Internal Revenue Service
Seattle 1, Washington

Office of
Internal Revenue Agent in Charge
Seattle Division
W. J. Jones & Son, Inc.,
817 Board of Trade Building,
Portland 4, Oregon.

Gentlemen:

I enclose a copy of the report of the examination of your income tax returns for the years 1946, 1948, in connection with your claim for a refund of \$12,190.32. After consideration by this office, the following adjustment of your tax liability appears to be warranted, for the reasons stated in the report:

Years: 1946, 1948 (See attached report for details).

If You Agree to this adjustment, the enclosed form of acceptance should be executed and forwarded to this office promptly, in order that a certificate of overassessment may be issued without unnecessary delay.

If You Do Not Agree to the proposed adjustment, you may file a protest, executed in triplicate under oath, with this office, within 30 days from the date of this letter, stating the grounds for your exceptions. Any protest so filed will have careful con-

Defendant's Exhibit No. 80—(Continued)

Revenue Agent who made prior examination: Kimberley.

With whom was examination discussed? Harold F. Smith, Sec.

Was an agreement to the findings procured? No.

Consents (date of expiration): 6/30/51 for 1946.

Claims (date and years covered): 11/4/49-1946.

Correspondence from the Bureau: None.

What other years, reported separately, were covered during this investigation? 1944 and 1947.

Other information:

This corporation had a bank overdraft close 1946; it paid a cash dividend of \$7,500.00 that year. In 1947 it paid a cash dividend of \$60,000.00. In 1948 it paid no dividend, but had an operating loss that year. At the close of 1948, its current liabilities exceeded its cash on hand. Non-application of Section 102 is recommended.

The capital stock of J. W. Jones & Son, Inc., was owned by the following:

	As at 12/31/46	1947	1948
(a) Clayton R. Jones	444 shares	364 shares	354 shares
(b) Clayton R. Jones, Jr...	77 shares	117 shares	132 shares
(b) William Jones	74 shares	114 shares	129 shares
(c) Marguerite E. Jones..	155 shares	155 shares	135 shares
	<hr/>	<hr/>	<hr/>
Total O/S	750 shares	750 shares	750 shares

(b) Sons of (a); (c) wife of (a).

Defendant's Exhibit No. 80—(Continued)

The account of Clayton R. Jones, on the books of this corporation showed the following balances:

12/31/45 Credit balance	\$11,388.60
12/31/46 Credit balance	9,874.26
12/31/47 Credit balance	26,521.91
12/31/48 Credit balance	13,003.19

In the year 1946, Jones' account was credited with \$121,763.74, face value of notes issued by Mina del Refugio, S. A., which were payable to Clayton R. Jones, and which he endorsed over to the taxpayer. Credit was also given for \$4,654.57, accrued interest on these notes at time of transfer. Clayton R. Jones endorsed these notes "without recourse."

The maker of these notes, Mina del Refugio, S. A., is a Mexican corporation, whose charter was issued in 1932. It was organized by persons in Arizona, who had through it conducted a mining operation. About 1944 it was dormant and had no assets or liabilities, but its charter had been kept alive by M. C. Little, Jr., a lawyer of Nogales, Arizona. Mr. John C. Higgins, Public Service Building, Portland, Oregon, learned of this and acquired the capital stock for a nominal consideration. The stock at the time was all issued to "Portador (bearer)" as follows:

Cert. 1, 2, 3 and 4 for 1249 shares each

Cert. 5, 6, 7 and 8 for 1 share each

The total authorized capital stock was and is 5000 shares, par value 1 peso each, or about 20c. It appears that these certificates, thus made out, were merely handed to Higgins, who thereby became the

Defendant's Exhibit No. 80—(Continued)

In the calendar year 1948, Clayton R. Jones claimed a bad debt in his personal return for \$28,222.21, and W. J. Jones & Son, Inc., has claimed a bad debt of \$134,555.21, determined as follows:

	Clayton R. Jones	W. J. Jones & Son, Inc
Face amount of notes	\$30,472.21	\$121,763.74
Less: Estimated recovery	2,250.00	8,775.00
	<hr/>	<hr/>
Remainder	28,222.21	112,988.74
Add:		
Accrued interest purchased....	none	4,654.57
Accrued interest reported as income	none (cash basis)	16,911.90
	<hr/>	<hr/>
Bad debt deduction claimed	\$28,222.21	\$134,555.21

John C. Higgins did not claim a bad debt in 1948 because he had organized on 10/1/48, the H. and H. Mines, Inc., and transferred all of his securities in mining companies thereto in exchange for its capital stock. This corporation did not file a return for the year ended 12/31/48, and appears to have elected a fiscal year. This return will be requisitioned as soon as it is determined from the Collector's office that it has been filed. It will probably claim a bad debt for the Mina del Refugio, S. A., notes. Form 917 will be submitted on Dennison E. Harris. The return of Clayton R. Jones is being obtained from the Collector's office for the year 1948.

On December 27, 1948, a special meeting of the Board of Directors of Mina del Refugio was held at 1303 Public Service Building, Portland, Oregon,

Defendant's Exhibit No. 80—(Continued)

at which it was resolved to abandon the corporation. A copy of these minutes is as follows:

Minutes of Special Meeting of Board of Directors
of
Mina del Refugio, S. A.

A special meeting of the Board of Directors of Mina del Refugio, S. A., was held at 10 o'clock a.m. on December 27, 1948, at 1303 Public Service Building, Portland, Oregon.

Present were John C. Higgins and Clayton R. Jones, constituting a quorum for the transaction of business.

Mr. Higgins acted as chairman and Mr. Jones acted as secretary.

Mr. Higgins and Mr. Jones discussed the hopeless plight into which the affairs of the Company had recently fallen. Mr. Higgins and Mr. Jones reviewed the reports of the Company's engineer, A. J. Klamt. Mr. Jones substantiated the conclusions in said reports from his personal observations made during his visits to the site of the mining operations in 1948, and particularly his last visit there, in November of 1948. On the basis of said reports and observations, which definitely established the exhaustion of all available ore capable of being mined with any hope of meeting operating expenses from the properties now owned and held under lease and option by the Company, and the failure of all plans to find other promising mining properties or to continue or resume milling operations on gambisino

Defendant's Exhibit No. 80—(Continued)

ore, Mr. Jones and Mr. Higgins agreed that the Company's mining and milling enterprise should immediately be ended and abandoned, that its saleable assets should be sold, the proceeds distributed to its creditors, its affairs should be wound up and the company should be dissolved.

Mr. Higgins and Mr. Jones then discussed the progress which had been made in dismantling the mill and mine equipment pursuant to their previous decision in the latter part of 1948 to curtail operations. Mr. Higgins submitted a copy of an agreement which he had prepared on behalf of the corporation providing for the sale of Mr. A. J. Klamt of all the structures, fixtures, equipment, and supplies connected with the mining operations of the company.

Upon motion duly made and seconded, the following resolutions were unanimously adopted.

Resolved, That the agreement confirmed in a letter dated December 27, 1948, from John C. Higgins to A. J. Klamt, a copy of which is ordered to be attached to the minutes of this meeting, be and hereby is approved and adopted by the Directors of the Company, and all acts of Mr. Higgins and Mr. Jones as officers and directors of the Company in entering into said agreement, and all acts of said persons in carrying out said agreement, and in taking all steps necessary and proper for the cessation and abandonment of all operations of the company be and hereby are ratified and approved by the Board of Directors.

Defendant's Exhibit No. 80—(Continued)

Mr. Higgins pointed out that the most that could be realized by the Company under said agreement was \$20,000, plus any additional portion of the Company's funds referred to in paragraph 3 of the agreement remaining after payment of the Company's outstanding liabilities. He stated that at most this additional sum, over and above the \$20,000 might amount to as much as \$2,500. He stated that there was no possibility that any sum over \$2,500 would be realized from this source and that the actual amount thus realized would probably be less than \$1,000. He also stated that, in his opinion, it was very doubtful whether even as much as \$20,000 would be realized by the Company from the sale of the equipment, structures and supplies. It was also explained by Mr. Higgins that paragraph eight of said agreement was inserted as a precautionary measure and that the Company did not anticipate the receipt of any money after December 31, 1948, on account of bullion payments, tax refunds or from other sources.

Mr. Jones observed that said agreement disposed of all the assets of the Corporation with the exception of the real property and mining claims owned by or under lease and option to the Company. Mr. Higgins and Mr. Jones agreed that the real property and mining claims were totally worthless. They were useless to the Company and could not be sold, since such properties have no value because of the exhaustion of all commercial ore deposits.

Defendant's Exhibit No. 80—(Continued)

Mr. Jones mentioned that the mine was flooded with water due to the cessation of pumping operations.

Upon motion duly made and seconded the following resolution was unanimously passed:

Resolved, that all real property and mining claims and all interests therein owned or held by the Company be and hereby are deemed to be worthless and the officers of the Company be and hereby are authorized and directed to abandon said property.

Mr. Higgins stated that there remained the question of what distribution should be made of the funds of the Company to be realized by the Company under the agreement with Mr. Klamt, plus any funds in the bank account of the Company referred to in paragraph 3 of said agreement. It was pointed out that there were outstanding notes of the Company and obligations for advances and equipment sales to it in the aggregate amount of more than \$300,000 which had been issued and incurred to evidence the obligation of the Company to repay the loans and advances, and for sales of equipment made from time to time by Mr. Higgins, Mr. Jones, and Mr. Dennison Harris and his family. Mr. Higgins expressed his regret that it was necessary to so bitterly disappoint the high expectations of full repayment for these loans, advances and sales, but stated that the most the Company could possibly pay on said notes and other obligations was a pro rated distribution of the above-mentioned sums which could not exceed \$22,500. Upon motion

Defendant's Exhibit No. 80—(Continued)

duly made and seconded the following resolution was unanimously passed:

Resolved, that the officers of the Company be and hereby are authorized and directed to make a pro rata distribution to the holders of the outstanding notes and other obligations of the Company of any and all funds of the Company realized under the agreement with Mr. Klamt confirmed in the letter from Mr. Higgins to Mr. Klamt dated December 27, 1948, plus any funds of the Company on deposit in its bank account after payment of all prior liabilities.

Mr. Higgins stated that the notes and other obligations of the Company, above mentioned, were obviously more than sufficient to exhaust all the assets of the Company so there was no need to make any provision for the stockholders of the Company since said stock under the circumstances was totally worthless.

Mr. Higgins and Mr. Jones then considered what disposition should be made of the corporate structure of the Company which would be nothing more than a hollow shell after December 31, 1948. Mr. Higgins and Mr. Jones determined that they were not sufficiently familiar with Mexican law to decide whether it would be most expeditious to dissolve the Company, or merely to abandon the corporate structure.

Upon motion duly made and seconded, the following resolution was unanimously passed:

Defendant's Exhibit No. 80—(Continued)

Resolved, that the officers of the Company be and hereby are directed and authorized to make whatever disposition of the corporate structure of the Company that they deem most advisable, such authority to include dissolution of the Company or abandonment of the corporate structure.

There being no further business, the meeting was adjourned.

/s/ JOHN C. HIGGINS.

/s/ CLAYTON R. JONES.

The undersigned, a director of Mina del Refugio, S. A., has read the foregoing minutes of a Special Meeting of the Board of Directors of the Company held on December 27, 1948. The undersigned hereby waives any and all notice required by law for the time, place and purpose of said meeting and hereby ratifies, approves and confirms all action taken at said meeting.

Dated as of December 27, 1948.

Nothing was ever paid on the notes of Mina del Refugio, S. A., either principal or interest, to the close of 1948. As the minutes disclose, it was estimated that about \$22,500.00 would ultimately be realized from the sale of the mining equipment and all other assets, except the mining claims and real property. The corporation resolved to abandon the

Defendant's Exhibit No. 80—(Continued)

real property and mining claims as worthless. This situation did not result in a closed transaction as at 12/31/48, and it is not clear that the capital stock represents a total loss in 1948. Provided that the capital stock and the notes are all considered as in reality the same, namely, risk capital which has the same status for income tax purposes, it is evident that the capital loss on this risk capital would come in the year that all the property of the corporation had been finally disposed of and proceeds realized. This requirement is not satisfied by establishing an estimated sum of \$22,500.00 as the amount to be realized. This estimate was divided among the note holders by agreement as follows:

John C. Higgins	50%	\$11,250.00
W. J. Jones & Son, Inc.	39%	8,775.00
Clayton R. Jones	10%	2,250.00
Dennison E. Harris	1%	225.00
		<hr/>
		\$22,500.00

The notes in question do not appear to qualify as securities, as defined in Sec. 23 (k) (3) of the Code, because not in registered form or with interest coupons attached. Because this is a corporation, there would not be a non-business debt. In the case of *Sam Schnitzer, et al., v. Commissioner*, 13 T.C. 43, the Court stated:

“A corporation's financial structure in which a wholly inadequate part of the investment is attributed to stock while the bulk is represented by bonds or other evidence of indebtedness to stockholders is lacking in the substance necessary for

Defendant's Exhibit No. 80—(Continued)

recognition for tax purposes, and must be interpreted in accordance with realities.”

For the reasons given above and in the body of this report, the deduction claimed of \$134,555.21 for bad debt in 1948 is not allowed.

Depreciation claimed was found to comply with T. D. 4422, and rates claimed are in line with those allowed in 1943 R.A.R. and considered reasonable.

Compensation of officers is paid within the 75-day period, and is reasonable. Other items of income and deduction were verified. \$48,700.00 of capital stock in Jones Pacific Co. subscribed in 1947 was cancelled at that figure in 1948, no gain or loss. Largely due to the above-mentioned bad debt deduction claimed, claims for carry-back were filed as follows:

Year of Claim	Claim	Amount of As Allowed
1944	\$30,865.50	\$3,996.95
1946	12,190.32	6,477.24
1947	38,030.29	1,830.37

/s/ CHAS. E. KIMBERLEY,
Internal Revenue Agent.

Class: Corp.

Grade: D

ebp

Statement of Total Tax Liability

[See photostate page 194 of this printed record.]

Preliminary Statement

[See pages 189 to 193 of this printed record.]

[Title of District Court and Cause.]

Civil No. 5758

CLERK'S CERTIFICATE

United States of America,

District of Oregon—ss.

I, Lowell Mundorff, Clerk of the United States District Court for the District of Oregon, do hereby certify that the foregoing documents consisting of complaint, answer, pre-trial order, findings of fact, conclusions of law and judgment, notice of appeal, motion for extension of time, order allowing extension of time, stipulation for order to send exhibits, order to send exhibits, affidavit of service of copy of designation, designation of record, and transcript of docket entries, constitute the record on appeal from a judgment of said court in a cause therein numbered Civil 5758, in which W. J. Jones & Son, Inc., is plaintiff and appellee, and Hugh H. Earle, Collector of Internal Revenue for the District of Oregon, is defendant and appellant; that the record has been prepared by me in accordance with the designation of contents of record on appeal filed by the appellant, and in accordance with the rules of this court.

I further certify that there is enclosed herewith duplicate transcript of proceedings of May 15-16, 1951, filed in this office in this cause (includes Civil 5759), Exhibits Nos. 1 to 80, inclusive, will go forward under separate cover by express.

In Testimony Whereof I have hereunto set my hand and affixed the seal of said court in Portland, in said District, this 1st day of November, 1951.

[Seal] LOWELL MUNDORFF,
Clerk.

By /s/ F. L. BUCK,
Chief Deputy.

[Title of District Court and Cause.]

Civil No. 5759

CLERK'S CERTIFICATE

United States of America,
District of Oregon—ss.

I, Lowell Mundorff, Clerk of the United States District Court for the District of Oregon, do hereby certify that the foregoing documents consisting of complaint, answer, pre-trial order, findings of fact, conclusions of law, and judgment, notice of appeal, motion for extension of time, order allowing extension of time, stipulation for order to send exhibits, order to send exhibits, affidavit of service of copy of designation, designation of record, and transcript of docket entries, constitute the record on appeal from a judgment of said court in a cause therein numbered Civil 5759, in which W. J. Jones & Son, Inc., is plaintiff and appellee, and the United States of America is defendant and appellant; that the record has been prepared by me in accordance with

the designation of contents of record on appeal filed by the appellant, and in accordance with the rules of this court.

I further certify that the duplicate transcript of proceedings of May 15-16, 1951, of this case also included the transcript in Civil 5758 and went forward with that appeal, as did exhibits Nos. 1 to 80, inclusive, which were shipped by express.

In Testimony Whereof I have hereunto set my hand and affixed the seal of said court in Portland, in said District, this 1st day of November, 1951.

[Seal] LOWELL MUNDORFF,
Clerk.

By /s/ F. L. BUCK,
Chief Deputy.

[Endorsed]: No. 13148. United States Court of Appeals for the Ninth Circuit. Hugh H. Earle, Collector of Internal Revenue for the District of Oregon, Appellant, vs. W. J. Jones & Son, Inc., a Corporation, Appellee. Transcript of Record. Appeals from the United States District Court for the District of Oregon.

Filed November 5, 1951.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

UNITED STATES OF AMERICA,
Appellant,
vs.

W. J. JONES & SON, INC.,
Appellee.

HUGH H. EARLE, Collector of Internal Revenue
for the District of Oregon,
Appellant,
vs.

W. J. JONES & SON, INC.,
Appellee.

STATEMENT OF POINTS ON WHICH AP-
PELLANTS INTEND TO RELY ON AP-
PEAL

Come now the United States of America and Hugh H. Earle, Collector of Internal Revenue for the District of Oregon, appellants above named, and for a statement of points upon which they intend to rely on this appeal say:

1. That the District Court erred in finding and holding that the plaintiff was entitled to a bad debt deduction of \$134,555.21 in computing its taxable income for the calendar year 1948.

2. That the District Court erred in finding and holding that 32 notes owned by the plaintiff in 1948, identified as Exhibits 13 to 44, inclusive, constituted

debt obligations within the meaning of Section 23 (k) of the Internal Revenue Code.

3. That the District Court erred in finding and holding that plaintiff properly charged off on its books in 1948 as a bad debt the \$134,555.21, as representing the extent to which the 32 notes, Exhibits 13 to 44, inclusive, were then considered worthless.

4. That the District Court erred in finding and holding that the advances evidenced by the 32 notes, Exhibits 13 to 44, inclusive, did not represent contributions to the Mexican corporation's capital by Clayton R. Jones.

5. That the District Court erred in finding and holding that if the stock ownership of Clayton R. Jones in the Mexican corporation or his activities in regard thereto are attributable to the plaintiff, then Findings of Fact XXIII through XXXIV support the District Court's conclusion that \$134,555.21 of plaintiff's \$138,379.48 net operating loss for 1948 was a bad debt, allowable as a deduction for 1948 under Section 23 (k) of the Internal Revenue Code.

6. That the District Court erred in finding and holding that the advances made to the Mexican corporation by Clayton R. Jones, evidenced by the 32 notes, Exhibits 13 to 44, inclusive, constituted loans, for income tax purposes, as distinguished from contributions to capital.

7. That the District Court erred in finding and

holding that Clayton R. Jones, John C. Higgins and D. E. Harris intended that their advances to the Mexican corporation should constitute loans within the meaning of the Internal Revenue laws, as distinguished from contributions to capital.

8. That the District Court erred in finding and holding that the advances made by Clayton R. Jones, John C. Higgins and D. E. Harris to the Mexican corporation created a debtor-creditor relationship within the meaning of the Internal Revenue laws.

9. That the District Court erred in basing its findings, conclusions and holdings upon the mere formal appearances of the transactions relating to the advances made to the Mexican corporation by Clayton R. Jones, John C. Higgins and D. E. Harris and ignoring the substance of said transactions.

10. That the District Court erred in finding and holding that Clayton R. Jones, John C. Higgins and D. E. Harris expected that their advances to the Mexican corporation would be repaid prior to the maturity dates of the notes issued to cover such advances.

11. That the District Court erred in finding and holding that the plaintiff is entitled to recognition for tax purposes as a separate entity distinct from Clayton R. Jones, insofar as the stock ownership of Clayton R. Jones in the Mexican corporation, and his advances thereto evidenced by notes transferred to the plaintiff, are concerned.

12. That the District Court erred in finding and

holding that the advances to the Mexican corporation were not made by the stockholders thereof in direct proportion to their stock interests.

13. That the District Court erred in failing to find and hold that the advances made by Clayton R. Jones, John C. Higgins and D. E. Harris to the Mexican corporation were intended to be, and were in fact in proportion to their stock interests.

14. That the District Court erred in finding and holding that the taxes herein sought to be recovered were excessive and were illegally and wrongfully withheld from plaintiff.

15. That the District Court erred in granting judgment herein in favor of the plaintiff and against the United States and against the defendant, Earle.

16. That the District Court erred in failing to find and hold that the advances made to the Mexican corporation by Clayton R. Jones, John C. Higgins and D. E. Harris were intended to and did constitute contributions to capital of the Mexican corporation.

17. That the District Court erred in failing to enter judgment for the defendants and against the plaintiff.

Dated this 2nd day of November, 1951, at Portland, Oregon.

/s/ HENRY L. HESS,

United States Attorney for
the District of Oregon.

/s/ DONALD W. McEWEN.

United States of America,
District of Oregon—ss.

Due and legal service of the within Statement of Points on Which Appellants Intend to Rely on Appeal is hereby accepted within the State and District of Oregon, on the 2nd day of November, 1951, by receiving a copy thereof duly certified to as a true and correct copy of the original.

/s/ WILLIAM H. KINSEY.

[Endorsed]: Filed Nov. 5, 1951.

[Title of Court of Appeals and Cause.]

DESIGNATION OF CONTENTS OF RECORD
ON APPEAL TO BE PRINTED

To the Clerk of the Above-Entitled Court:

The Record on Appeal having been transmitted by the Clerk of the District Court to the Clerk of the United States Court of Appeals for the Ninth Circuit for docketing, the appellants hereby designate the portions of the record to be printed as follows:

(1) Exhibits 6 to 13, inclusive, 46, 50, 52 to 80, inclusive.

(2) Exhibit 49—the stubs for stock certificates actually issued.

(3) Exhibit 51—ledger sheets for the following accounts:

Organization Expense.

Exploration & Development Expense.

Trucks and Tractors.

Office Equipment.

Camp.

Water System.

Mill Building.

Mine Equipment.

Mill Equipment.

(4) Exhibit 51—ledger sheets for accounts showing sums advanced by Clayton R. Jones, John C. Higgins and D. E. Harris.

(5) All of the remaining portions of the record.

HENRY L. HESS,

United States Attorney for
District of Oregon.

/s/ DONALD W. McEWEN,

Assistant United States Attorney, of Attorneys for
Appellants.

Service admitted.

[Endorsed]: Filed Nov. 12, 1951.



**In the United States Court of Appeals
for the Ninth Circuit**

**HUGH H. EARLE, COLLECTOR OF INTERNAL REVENUE FOR
THE DISTRICT OF OREGON, APPELLANT**

v.

W. J. JONES & SON, INC., A CORPORATION, APPELLEE

UNITED STATES OF AMERICA, APPELLANT

v.

W. J. JONES & SON, INC., A CORPORATION, APPELLEE

**ON APPEALS FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON**

BRIEF FOR THE APPELLANTS

ELLIS N. SLACK,
Acting Assistant Attorney General.

I. HENRY KUTZ,
Special Assistant to the Attorney General.

HENRY L. HESS,
United States Attorney.

DONALD W. McEWEN,
Assistant United States Attorney.

FILED

MAR 12 1952

PAUL P. O'BRIEN
CLERK

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**In the United States Court of Appeals
for the Ninth Circuit**

No. 13,148

HUGH H. EARLE, COLLECTOR OF INTERNAL REVENUE FOR
THE DISTRICT OF OREGON, APPELLANT

v.

W. J. JONES & SON, INC., A CORPORATION, APPELLEE

UNITED STATES OF AMERICA, APPELLANT

v.

W. J. JONES & SON, INC., A CORPORATION, APPELLEE

*ON APPEALS FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON*

BRIEF FOR THE APPELLANTS

OPINION BELOW

The District Court rendered no opinion; its findings of fact and conclusions of law are to be found at R. 52-66.

JURISDICTION

These appeals involve two suits for refund of income and excess profits taxes alleged to have been illegally

and wrongfully withheld from taxpayer, both instituted in the United States District Court for the District of Oregon. The taxes for which refund is sought in District Court Civil No. 5758 (against the Collector) were collected by Hugh H. Earle, who, subsequent to September 1, 1947, was, and now is, the duly appointed, qualified and acting Collector of Internal Revenue for the District of Oregon. (R. 53-54.) The taxes for which refund is sought in District Court Civil No. 5759 (against the United States) were collected by J. W. Maloney, who, prior to September 1, 1947, was the duly appointed, qualified and acting Collector of Internal Revenue for the District of Oregon, and was not in office as Collector of Internal Revenue for the District of Oregon when that action was commenced, and has not been in office since September 1, 1947. (R. 53.) Jurisdiction of the District Court over Civil No. 5758 (against the Collector) exists by virtue of 28 U.S.C., Section 1340, and jurisdiction of the District Court over Civil No. 5759 (against the United States) exists by virtue of 28 U.S.C., Section 1346. (R. 54.)

The two actions involve the same controversy and were divided into two complaints by plaintiff only for pleading and the jurisdiction purposes above noted. (R. 36.) The cases were consolidated by consent of the parties and approval of the court (R. 36-37, 52); they were tried together (R. 76); and a single judgment, which is the judgment appealed from, was entered in both of them (R. 66-67).

On or about April 20, 1945, taxpayer filed its income and excess profits tax returns for the year 1944, disclosing an income tax liability of \$19,677.81 and an excess

profits tax liability of \$49,871.47, which taxpayer paid in instalments during the year 1945. (R. 55.)

On or about May 16, 1947, taxpayer filed its income tax return for 1946, disclosing an income tax liability of \$12,190.32, which taxpayer paid in instalments during the year 1947. (R. 54.)

On or about May 17, 1948, taxpayer filed its income tax return for 1947, disclosing an income tax liability of \$154,791.75, which taxpayer paid in instalments during the year 1948. (R. 54.)

On or about March 15, 1949, taxpayer filed its income tax return for the year 1948, in which taxpayer claimed a bad debt deduction of \$134,555.21, constituting part of an operating loss for 1948 in the amount of \$138,379.48. (R. 54.)

On November 4, 1949, taxpayer filed with the Collector of Internal Revenue for the District of Oregon a refund claim for the calendar year 1946 (Pltf. Ex. 6, R. 172-175), in which taxpayer claimed a refund of \$12,190.32, resulting primarily from a net operating loss deduction attributable to the carry-back to 1946 of the \$138,379.48 net operating loss claimed to have been sustained in 1948. (R. 55.)

On November 4, 1949, taxpayer filed with the Collector of Internal Revenue for the District of Oregon a refund claim for the year 1947 (Pltf. Ex. 7, R. 176-178), in which taxpayer claimed a refund of \$38,030.29, resulting from a net operating loss deduction attributable to the carry-back to 1946 of the \$138,379.48 net operating loss claimed to have been sustained in 1948 and the carry-forward from 1946 to 1947 of the

amount of the net operating loss deduction not absorbed by 1946 net income. (R. 55.)

On November 4, 1949, taxpayer filed with the Collector of Internal Revenue for the District of Oregon a refund claim for the year 1944 (Pltf. Ex. 8, R. 179-184), in which taxpayer claimed a refund of excess profits taxes in the sum of \$30,865.50, resulting from an unused excess profits credit carried back from 1946 to 1944, due to the elimination of taxpayer's 1946 income by the asserted 1946 net operating loss deductions attributable to the claimed carry-back of the \$138,379.48 net operating loss sustained in 1948. This refund claim disclosed the unused excess profits credit carry-back resulted in an asserted income tax deficiency of \$14,947. (R. 56.)

Taxpayer did not receive by registered mail any notice of allowance or disallowance of these refund claims for 1944, 1946, and 1947, within the time prescribed in Section 3772 of the Internal Revenue Code, and on September 27, 1950 (R. 3-4), being more than six months after the filing of the refund claims, taxpayer brought the two actions above described in the District Court for recovery of the taxes paid against the Collector (R. 5-14), and against the United States (R. 18-33).

A single judgment was entered in both actions in favor of taxpayer on June 12, 1951, in the amount, in the action against the Collector, of \$43,220.61 and, in the action against the United States, of \$37,865.50. (R. 66-67.) Notices of appeals from this judgment of the District Court were timely filed by the Collector and the United States, respectively, on August 8, 1951

(R. 67-69), in compliance with 28 U.S.C., Section 2107. Jurisdiction of this Court to hear and determine this appeal is conferred by 28 U.S.C., Section 1291.

QUESTION PRESENTED

Whether the advances to the Mexican Corporation, upon which was founded the alleged bad debt deduction claimed by taxpayer, constituted capital contributions and not loans, and, hence, were not deductible as bad debts within the meaning of Section 23 (k) (1) of the Internal Revenue Code.

STATUTE INVOLVED

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(k) [As amended by Section 124 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and Section 113 (a) of the Revenue Act of 1943, c. 63, 58 Stat. 21] BAD DEBTS.—

(1) *General Rule*.—Debts which become worthless within the taxable year; or (in the discretion of the Commissioner) a reasonable addition to a reserve for bad debts; and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction. This paragraph shall not apply in the case of a taxpayer, other than a bank, as defined in section 104, with respect to a debt evidenced by a security as defined in paragraph (3) of this subsection.

This paragraph shall not apply in the case of a taxpayer, other than a corporation, with respect to a non-business debt, as defined in paragraph (4) of this subsection.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

STATEMENT

These are actions for refund of excess profits taxes paid by taxpayer for the year 1944 and income taxes paid by taxpayer for the years 1946 and 1947. While the actions technically involve the years 1944, 1946 and 1947, the real basis of the controversy is an alleged 1948 bad debt deduction in the sum of \$134,555.21 claimed by taxpayer as the major portion of an alleged net operating loss disclosed on its 1948 income tax return. The Government asserts that the advances upon which the alleged bad debt deduction is based constituted capital contributions to a Mexican corporation and not loans to it and, hence, could not form the basis for a bad debt deduction. Hence, defendants denied the 1948 bad debt deduction and the resulting portion of the 1948 net operating loss.

If the 1948 bad debt deduction is allowable, as held by the court below, it increases taxpayer's 1948 net operating loss by the amount of the deduction. In such event, the net operating loss may be carried back and reflected in the years 1944, 1946 and 1947, and form the basis for the refunds to taxpayer for those years granted in the judgment appealed from. (R. 37, 66-67.)

The cases were tried before Judge McColloch without jury. (R. 52.) Previously a pre-trial order had

been made by Judge Solomon (R. 36-51), containing a statement of the facts admitted by both sides (R. 37-41), identifying a list of eighty exhibits (R. 47-51), and setting forth the contentions of the parties and the issues to be decided.

At the trial two witnesses testified for taxpayer and one for the Government, and the eighty exhibits marked for identification at pretrial were received in evidence. (R. 78-82, 169.)

The findings of the District Court do not set forth the primary facts, but are limited essentially to ultimate conclusions of fact, many of which, the Government contends, are clearly erroneous, for reasons hereinafter set forth. For an understanding of the issue, however, a statement of the primary facts is requisite. The primary facts are documentary in character or contained in uncontradicted testimony of taxpayer's witnesses, and are substantially not in dispute. A statement of these undisputed facts, as far as possible in chronological order, follows:

In June, 1944, one D. D. Kroder interested Clayton R. Jones in a Mexican gold mine located approximately two hundred miles south of the border. (R. 83, Pltf. Ex. 52, R. 255-258.)¹ Kroder had an option to purchase the mining rights for \$35,000, \$10,000 down and the balance payable out of royalties within four years. (R. 256-257.) Jones contacted a friend, D. E. Harris, who made a preliminary examination and submitted a

¹ The only exhibit marked as defendants' exhibit is No. 80 (revenue agent's report). (R. 169.) Hence, Exhibits 1-79, inclusive, will, without further mention, be understood to be plaintiff's exhibits.

favorable report. Jones then interested John C. Higgins, of Portland, Oregon, who possessed experience in underground mining, which Jones lacked. (R. 84.) They sent two men, selected by Higgins, to make a further examination of the property. This investigation culminated in a mining option dated July 31, 1944, made between Kroder, as first party, and Jones and Higgins, as second parties (Ex. 53, R. 258-261), wherein Kroder granted an option to the second parties to acquire Kroder's option for the purchase of the mine. In the event the second parties exercised the option, the following agreements were to be effective (R. 260-261):

4. Parties hereto contemplate the organization of a Mexican corporation to be named as grantee in the deed conveying said mining property and the \$35,000 provided by second parties hereto shall be in the form of a loan to said corporation represented by notes of the corporation and repayable within two years from their date, with interest at five per cent. Said notes shall be payable either at or before their maturity before any dividends shall be declared by said corporation.

5. The stock of the aforesaid corporation shall be distributed one-third to first party and two-thirds to second parties.

6. First party agrees to devote all of his time to the management of the affairs of said corporation during a development period of four months and he shall receive therefor a salary of Three Hundred Dollars (\$300.00) per month. In case the parties shall desire to continue the arrangement with first party for his services after said initial period of four months it shall be under such agreement as to

salary and terms as may be made by the parties hereto.

Kroder was allowed the $1/3$ interest in the venture in consideration of finding the project plus the undertaking to devote full time to its development for a period of four months at a salary of \$300 a month. (R. 86.) However, about ten days later (August 9, 1944), by a supplemental agreement between the same parties, Kroder consented to reduce his interest in the undertaking to 20%, of which $1/2$ was to be held by a certain A. E. Johnson, and the remaining 10% by himself. On the other hand, Kroder was released from the obligation to devote time to the management of its affairs and was not to get any salary. (Ex. 54, R. 262-263.) The next day, on August 10, 1944, D. E. Harris, as agent and trustee of Jones and Higgins, acquired a contract to purchase the mine property from one Robinson, who owned or controlled it. (R. 87-88; Ex. 55, R. 264-269.)

Thereafter, the parties, through Higgins, communicated with Malcolm Little, of Nogales, Arizona, a lawyer, qualified to practice both in the United States and Mexico. (R. 127.) Higgins told him that they planned to organize a Mexican corporation to carry on the mining operation, because there were other parties than Jones and himself; except for this outside participation, he and Jones would have operated as a partnership. Little advised him strongly not to operate as an American partnership and not to organize a new Mexican corporation or American corporation, since an American corporation would probably not be quali-

fied to do business under Mexican laws at all, and, if a new Mexican corporation was organized, the Mexican law would require 51% of the stock to be owned by Mexican citizens. (R. 128.) Instead, Little recommended taking over an existing Mexican corporation, organized before the enactment of the Mexican statute requiring Mexican companies to have at least 51% Mexican stock ownership. (R. 129-130.) Little had preserved in his office the corporate structure of such a Mexican corporation, organized in 1932, and sold it to Jones, Higgins and Harris. (R. 88, 129-130.) This corporation was named "Mina del Refugio, S.A.", usually hereinafter referred to as the "Mexican Corporation". (R. 88.) On October 31, 1944, the Mexican Corporation acquired from their owners the mining rights referred to in Exhibit 55 (R. 88, Ex. 56, R. 269-289), for the sum of \$40,000, \$10,000 down and \$10,000 on August 10th of each of the next succeeding three years. From each annual instalment was to be deducted the amount to be received as royalty in each preceding year by the mine owners, the Mexican Corporation to pay only the difference between \$10,000 and the amount of royalties thus received. (R. 274.) On November 20, 1944, an agreement (Ex. 57, R. 290-294) was entered into between Jones, Higgins and Harris as "First Parties" and the Mexican Corporation as the "Company", which provided among others that the first parties had procured the transfer of the mining rights under the agreement of October 31, 1944 (Ex. 56), to the Mexican Corporation, that they had expended \$10,000 in making the first payment on the purchase price of the mining claims, and also expended the further sum of \$13,668.40 in the investigation, ex-

ploration, development and equipment of these mining properties for operation (R. 290), and that (R. 291-294) :

The Company will require further large sums of money and additional equipment and materials to continue the exploration, development and exploitation of said mining properties and to make further payments on the purchase price thereof, and First Parties hereby offer to provide the Company with money and equipment and materials for the foregoing purposes under the following terms and conditions:

Clauses:

First: First Parties shall provide such sums of money and such items of equipment, materials and supplies for the foregoing purposes as shall be mutually agreed upon by the Company and First Parties, and as consideration therefor, and as consideration for the procurement of the aforesaid option, the Company shall be bound to First Parties as follows:

(a) Promptly after the execution of this agreement, the Company shall execute and deliver to each of First Parties its notes for the full amounts theretofore expended by such party for and on account of the investigation, examination, exploration, development and equipment of the Robinson mining properties, and for payment on the purchase price under the aforesaid option agreement thereon; said notes shall be payable two years after date and shall bear interest at six per cent per annum from the date when the principal sum represented by such note was expended by the payee for the purposes above stated, interest being payable at the maturity of the note.

(b) On or about the last day of each month hereafter, the Company shall execute and deliver to each of the First Parties its note or notes for all amounts advanced to the Company or expended for its benefit by such party during such month, at the request of the officers of the Company, for or on account of the exploration, development, equipment or exploitation of the aforesaid Robinson mining properties or for payment on the purchase price under the aforesaid option agreement, or for other Company purposes; said notes shall be payable two years after date and shall bear interest at six per cent per annum from the date of the advance or the expenditure by the payee of the principal sum represented by such note, interest being payable at the maturity of the note; provided, however, that promptly after the execution of this agreement, First Parties shall pay to the Banco Nacional de Mexico, at Hermosillo, Sonora, for credit to the account of Arthur E. Johnson, Trustee, for the use and benefit of the Company, the sum of 5,000 pesos, Mexican currency; said sum shall be in full payment of the "capital social" of the Company, and shall constitute the Company's "capital social" without any obligation or indebtedness therefor from the Company to said Jones, Harris and Higgins, and without the issuance of any note or notes therefor, and the capital stock of the Company shall thereby become fully paid.

(c) Upon demand of the parties entitled thereto, the Company shall execute and deliver to each of the First Parties its note or notes, payable two years after date, for the agreed purchase price and reasonable value of all used equipment heretofore or hereafter sold and delivered to the Company; the principal sum of said note or notes shall

bear interest at six per cent per annum from the date or dates when the equipment represented thereby shall have been delivered for use at the Robinson mining properties, said interest being payable at maturity.

(d) All monies advanced or expended by First Parties for any of the purposes described in Clauses (a) and (b) above, together with the amounts representing the reasonable purchase price and value to the Company of the mining and milling equipment sold and delivered to the Company as stated in Clause (c) above, together with interest thereon in accordance with the terms above stated, shall become obligations of the Company from the dates when such monies were advanced or expended and from the dates of delivery to the Company of the aforesaid equipment, and the Company shall be and remain indebted under open account for the aforesaid amounts and interest therein as aforesaid to the respective persons who advanced or expended the monies or who sold and delivered the equipment, until such persons shall have been reimbursed by the Company therefor or until the Company shall have executed and delivered to such persons its note or notes therefor as above provided.

(e) Upon demand therefor by the party entitled thereto, the Company shall execute and deliver to each of the First Parties chattel mortgages on all items of equipment sold and delivered to the Company by such party, giving to such party a lien on such items of equipment to secure the payment of the purchase price therefor and the interest thereon as above provided.

Higgins as president and Harris as secretary signed this agreement on behalf of the company. (R. 294.)

Earlier the same day (November 20, 1944), the board of directors of the Mexican Corporation, consisting of Harris, Jones and Higgins, had met in Portland, Oregon, for the purpose of considering (Ex. 58, R. 295)—

a plan that would enable the Company to procure the money necessary for the exploration, development, operation and acquisition of the mining claims * * *.

Mr. Jones presented to the board a draft of the proposed agreement (Ex. 57), whereby Messrs. Harris, Jones and Higgins offered to advance to the company funds for the foregoing purposes upon the terms stated in the proposed contract (R. 295). The proposed agreement was accepted and ratified (R. 295), and it was further (R. 296-298):

Resolved that either the President or the Vice President of the Company is authorized and directed to execute and deliver to Messrs. Jones, Harris and Higgins, upon their respective demands, notes of the Company in accordance with the terms of said agreement, in such amounts and at such times as the officers of the Company shall determine are required by the terms of said agreement in consideration for the following:

(a) All monies heretofore or hereafter expended by said Jones, Harris and Higgins, respectively, for and on account of the examination of the properties covered by the aforesaid option and the acquisition of said option and the making of payments thereunder;

(b) All monies heretofore or hereafter advanced or expended by said Harris, Jones and Hig-

gins, respectively, for and on account of the exploration and development of the mining claims covered by the aforesaid option and the prosecution of mining operations thereon;

(c) All monies heretofore or hereafter advanced or expended by said Jones, Harris and Higgins, respectively, for and on account of the purchase, repair, transportation and delivery of mining equipment, materials and supplies used on and in connection with the exploration, development and mining operations carried on by said Jones, Harris and Higgins and/or by this Company on the mining properties covered by said option;

(d) All monies advanced or paid out by said Jones, Harris and Higgins, respectively, for expenses or other obligations of the Company incurred in the course of its business, or deposited by said Jones, Harris and Higgins, respectively, to the credit of Arthur E. Johnson, Trustee in the Banco Nacional de Mexico or the First National Bank of Nogales, and thereafter expended for the use and benefit of the Company; provided, however, that said Jones, Harris and Higgins shall promptly hereafter pay to the Banco Nacional de Mexico, at Hermosillo, Sonora, for credit to the account of Arthur E. Johnson, Trustee, for the use and benefit of the Company, the sum of 5,000 Pesos, Mexican currency; said sum shall be in full payment of the "capital social" of the Company and shall constitute the Company's "capital social" without any obligation or indebtedness therefor from the Company to said Jones, Harris and Higgins, and without the issuance of any note or notes therefor and the capital stock of the Company shall thereby become fully paid;

(e) For such amounts as shall represent the reasonable purchase price and value to the Com-

pany of all mining and milling equipment, materials and supplies owned by said Jones, Harris and Higgins, respectively, and sold and delivered by them to the Company for the Company's use in the exploration, development and mining of the properties described in the aforesaid option.

Third: Resolved that all monies advanced or expended by said Harris, Jones and Higgins for any of the purposes described in Clauses (a), (b), (c), (d) above, together with the amounts representing the reasonable purchase price and value to the Company of the mining and milling equipment, materials and supplies sold and delivered to the Company as stated in Clause (c) above, together with interest thereon in accordance with the terms of the aforesaid proposed agreement, shall become obligations of the Company from the dates when such monies were advanced or expended and from the dates of delivery to the Company of the aforesaid equipment, materials and supplies, and the Company shall be and remain indebted under open account for the aforesaid amounts and interest thereon as aforesaid to the respective persons who advanced or expended the monies or who sold and delivered the equipment, materials and supplies, until such persons shall have been reimbursed by the Company therefor or until the Company shall have executed and delivered to such persons its note or notes therefor as above provided.

Higgins testified at the trial that the whole plan of advances to the Mexican Corporation was set up on the advice of Mr. Little. Higgins had suggested

that 5,000 pesos or about \$1,000 seemed inadequate capital, and had also suggested issuance of preferred stock, but Little advised the parties not to tamper with the corporate structure in any way, because of uncertainty of what might happen when the Mexican courts came to interpret the recent statute requiring that operations be 51% owned by Mexican citizens; that it was preferable that they leave the capital stock structure as it was and provide money for the corporation by way of loans. (R. 154-156.) (Due to printer's error the record (154) reads "adequate capital", instead of "*inadequate*" as in the transcript (p. 82); and see R. 156.)

In March, 1945, Jones, Higgins and Harris entered into an agreement (Ex. 59, R. 300-302) which provided among others (R. 300-302)—

that funds for the acquisition, exploration, development and exploitation of said mining properties, should be contributed as follows: \$3,000 by said D. E. Harris and members of his family; 50% of the balance of said funds by Clayton R. Jones, and 50% thereof by John C. Higgins. In pursuance of said agreement, said D. E. Harris has heretofore contributed \$1,500; Robert F. Harris has contributed \$1,000 and R. Blaine Harris, has contributed \$500, making a total contribution by said Harris and members of his family, of \$3,000. Said Clayton R. Jones and John C. Higgins have each contributed approximately \$15,000 in cash and they have each made additional substantial contributions in mining and operating equipment, and they plan to make further contributions of cash and operating equipment.

4. It has been agreed by and between the parties hereto that ten per cent (10%) of the stock of the aforesaid Corporation shall be issued to Arthur E. Johnson, or his assigns, ten per cent (10%) to Daniel D. Kroder, or his assigns, and the remaining eighty per cent (80%) of the stock of said Corporation shall be divided between Clayton R. Jones, John C. Higgins and the above-named members of the Harris family, in proportion to their respective contributions in cash and in equipment, at its reasonable value, and that such stock shall be so distributed when the total of said contributions, as finally made, has been determined.

It has also been agreed by and between the parties hereto that all of the contributions of said parties, except the amount thereof required to pay up the 5,000 pesos capital stock of said Corporation, shall be regarded as loans to said Corporation, to be represented by notes of said Corporation and to be repayable within two years from the respective dates when said contributions in cash and equipment were made, with interest at five per cent (5%) per annum, and that said notes shall be payable either at or before their maturity, before any dividends shall be declared by said Corporation.

Both Jones and Higgins testified that it was the agreement they were to have stock in proportion to advances made. (R. 110, 160.)

The Mexican Corporation's general ledger (Ex. 51) showed extensive advances by Jones (R. 252-253) and Higgins (R. 254), respectively, during the period from August, 1944, to the end of 1947, amounting in the case of each to more than \$150,000. Harris' contribution was limited to \$3,000. (R. 255, 300.)

At various intervals beginning with November 30, 1944, and ending December 31, 1946, thirty-two notes of the Mexican Corporation in the aggregate principal amount of \$121,763.74 were issued to Jones, each payable in two years with interest at 6%, in return for cash advances made to the Mexican Corporation. (R. 91.)²

² The notes were admitted in evidence as Exhibits 13 to 44, inclusive (R. 79), each bearing the following dates and in the following amounts:

Exhibit No.	Date	Amount
13	11/30/44	\$5,000.00
14	11/30/44	545.71
15	11/30/44	620.40
16	11/30/44	3,165.34
17	11/30/44	1,477.88
18	12/31/44	2,109.02
19	1/31/45	2,870.79
20	2/28/45	1,506.28
21	3/31/45	1,332.69
22	4/30/45	1,787.26
23	5/31/45	2,750.46
24	6/30/45	2,475.62
25	7/31/45	1,894.50
26	8/7/45	5,000.00
27	8/31/45	2,499.67
28	9/7/45	5,300.00
29	9/30/45	3,607.62
30	10/31/45	2,212.53
31	11/30/45	2,503.96
32	12/30/45	2,575.76
33	1/31/46	2,155.70
34	2/28/46	2,828.67
35	3/30/46	6,018.42
36	4/30/46	6,935.80
37	5/31/46	9,905.28
38	6/29/46	6,580.24
39	7/31/46	8,673.25
40	8/31/46	8,598.11
41	9/30/46	5,693.83
42	10/31/46	3,790.13
43	11/30/46	4,827.92
44	12/31/46	4,520.90

These exhibits form part of the record on appeal (R. 71-72) and should be available to the Court at the time of argument.

Above that amount Jones had made additional advances in the sum of about \$30,000, which made the total of his advances, as aforesaid, in excess of \$150,000 (R. 91). Additional notes were issued to Jones representing these advances in the amount of \$30,472.21. (R. 367.)

The contributions made by Jones to the Mexican Corporation had been made by withdrawing funds from taxpayer corporation, W. J. Jones & Son, Inc., the withdrawals being charged to Jones' personal account. (R. 92-93, 104-105.) Jones and members of his family owned all of the outstanding stock of taxpayer corporation (R. 104), of which Jones personally owned from 47% to 59% between 1945 and 1948 (R. 109; Deft. Ex. 80, R. 364). Taxpayer is in the stevedoring and ship fitting business. (R. 114.)

The notes were sold to taxpayer at their face value, without recourse. (R. 92.) On August 31, 1946, Jones endorsed to taxpayer corporation twenty-eight of the thirty-two notes issued by the Mexican Corporation in the face amount of \$102,930.96. (Exs. 13-40, R. 92, 94.) On December 31, 1946, Jones endorsed the remaining four notes (Exs. 41-44) to taxpayer corporation in the face amount of \$18,832.78 (R. 92, 94). Jones was also credited by taxpayer with the accrued interest of \$4,654.57 on the twenty-eight notes transferred in August. No interest was credited to Jones for the four notes transferred in December, 1946, these having been issued on September 30, October 31, November 30, and December 31, 1946. After these credits Jones still owed taxpayer corporation three

or four thousand dollars. (R. 94.) See the journal entries for these transactions on taxpayer's books. (Ex. 65, R. 319, and Ex. 66, R. 321.)

The stock record book of the Mexican Corporation reveals that its 5,000 shares stood in the names of Enrique Torres and M. C. Little from January 11, 1932, to March 22, 1948. (Ex. 49, R. 241-242.) On March 22, 1948, all the stock was issued as follows (R. 160, 243, 245, 366): To Higgins—2,256 shares; Jones—2,156 shares; Scott—300 shares; Wells—250 shares; D. E. Harris—19 shares; R. L. Harris—13 shares; and R. B. Harris—6 shares.

During the same period between August, 1944, and the end of 1947, Higgins had advanced to the Mexican Corporation approximately the same sums as Jones (R. 114), for which he also received notes in the amount of \$153,142.44 (R. 145, 367).

In 1948 it was ascertained that the mining venture would probably not bring the large profits theretofore anticipated as the rich veins of ore became exhausted and no new veins were found. (R. 100-101.) In November, 1948, it was decided to abandon the project and the engineer on the job was authorized to sell the machinery and equipment. (R. 101-103.)

Neither the principal nor interest³ on the notes was paid, except that a small amount was realized upon liquidation of the project towards the end of 1948 and

³ Taxpayer being on the accrual basis, each month accrued interest on the notes transferred to it and paid income taxes on the interest so accrued. (R. 94-95.) However, in connection with disallowance of the bad debt deduction, adjustment was made reducing taxpayer's income for such accrued interest reported. (R. 163.)

applied *pro rata* on the outstanding notes. The liquidating agreement between the engineer at the mine and the Mexican Corporation provided that (Ex. 75, R. 344-345):

3. By December 31, 1948, if possible, or as soon thereafter as it can be accomplished, you are to pay from the company's funds on hand, or in bank, all of the Company's outstanding accounts, pay rolls and liabilities, and you are to transmit to the Valley National Bank, the full balance of any funds then on hand in Hermosillo for deposit in the account of Mina del Refugio, S. A., except that you may retain, as a revolving fund, in the bank at Hermosillo, a balance of 5,000 pesos, or its equivalent in United States currency, for your convenience in meeting local expenses involved in the dismantling, shipping, handling and sale of the equipment, materials and supplies.

The board of directors of the Mexican Corporation in a resolution ratified this agreement and adopted a resolution (Ex. 76, R. 352-353)—

that the officers of the Company be and hereby are authorized and directed to make a *pro rata* distribution to the holders of the outstanding notes and other obligations of the Company of any and all funds of the Company realized under the agreement with Mr. Klamt confirmed in the letter from Mr. Higgins to Mr. Klamt dated December 27, 1948, plus any funds of the Company on deposit in its bank account after payment of all prior liabilities.

The entire amount to be salvaged under this agreement was estimated to be \$22,500 (R. 350-351), and was

apportioned among the note holders by agreement as follows (R. 375):

John C. Higgins	50%	\$11,250.00
W. J. Jones & Son, Inc.	39%	8,775.00
Clayton R. Jones	10%	2,250.00
Dennison E. Harris	1%	225.00
		<hr/>
		\$22,500.00

Taxpayer, on December 31, 1948, entered on its books an estimated recovery on the notes received from Jones in the amount of \$8,755⁴ and charged off on its books the balance of \$134,555.21 (notes, \$121,763.74, plus interest receivable \$21,566.47) as a bad debt. (R. 58-59, 92-93, 95-96; taxpayer's journal entries, Ex. 78, R. 358, 360.)

The deduction of this item from gross income for 1948 as a bad debt deduction was denied by the Commissioner (R. 162-163), and the present suits followed.

Upon this record the District Court found as facts, among other things, as follows:

When the thirty-two notes were received by taxpayer in 1946, for an aggregate consideration of \$126,418.31, the notes were reasonably worth this consideration and taxpayer and the officers of the Mexican Corporation fully expected that the notes and interest would be fully paid (Finding XVII, R. 57); that the thirty-two notes were worthless in 1948 to the extent of \$134,555.21, this amount being the difference between \$143,330.21 (the consideration paid and accrued by taxpayer for the notes) and \$8,775 (the maximum amount which tax-

⁴ The actual amount recovered was \$8,694.42. (R. 93.)

payer could expect to recover on the notes) (Finding XX, R. 58). At no time did taxpayer own any capital stock or any other equity interest in the Mexican Corporation (Finding XXII, R. 59); advances in the aggregate sum of \$308,378.39 were made by Jones, Higgins and Harris, evidenced by notes duly made, executed and delivered by the Mexican Corporation (including the thirty-two notes assigned by Jones to taxpayer for value), and that at the time of making these advances Jones, Higgins and Harris intended that the advances should constitute loans and create a debtor-creditor relationship, and all subsequent actions of Jones, Higgins and Harris in regard to these advances (and the notes evidencing same), have been consistent with such intention that the advances constituted loans and created a debtor-creditor relationship (Finding XXV, R. 60).

The lower court further found that Kroder and Johnson never made any advances or contributions to the Mexican Corporation, and the 80% balance of the capital stock of the Mexican Corporation was owned by Jones, Higgins and Harris (Finding XXVII, R. 61); that the mining rights acquired by Jones, Higgins and Harris from Kroder and Johnson were transferred to the Mexican Corporation through the execution of an option and lease agreement dated October 31, 1944, in the name of the Mexican Corporation (Ex. 56), and the mining rights at the time of this transfer to the Mexican Corporation had a very substantial value in excess of the amount payable under the option and lease agreement, and this transfer of mining rights to the Mexican Corporation by Jones, Higgins and Harris constituted

contributions to the capital of the Mexican Corporation (Finding XXVIII, R. 61). The District Court also found that in the spring of 1945 a third person, Walter M. Wells, and his associates paid \$5,000 for the 10% stock interest of Kroder in the Mexican Corporation, and in March, 1946, Jones and Higgins paid \$4,000 for the 9% stock interest of Johnson in the Mexican Corporation (Johnson previously having transferred a 1% to an associate of Wells), and the asset accounting for such value of the stock was the excess in the value of the mining rights over the amounts payable under the option and lease agreement. (Finding XXIX, R. 61-62.) The court also found that whether or not the transfer of the mining rights by Jones, Higgins and Harris to the Mexican Corporation constituted contributions to capital, the advances made by Jones, Higgins and Harris to the Mexican Corporation evidenced by the notes duly issued by the Mexican Corporation were intended to constitute, and did constitute, loans rather than contributions to capital (Finding XXX, R. 62); and that the advances to the Mexican Corporation were not made by the stockholders thereof in direct proportion to their stock ownership, because Kroder and Johnson owned 20% of the capital stock, but made no advances whatsoever to the corporation (Finding XXXI, R. 62).

The lower court also found that there were business reasons why Jones, Higgins and Harris intended that their advances to the Mexican Corporation should constitute loans, in that they desired to be repaid such advances before anything was received by or accrued to the finders (Kroder and Johnson), who paid nothing

for their 20% stock interest, and they desired to be in as strong a position as possible in the event that the Mexican authorities or general creditors made claims against the corporation. (Finding XXXII, R. 62.)

The District Court also found that at the time of the execution of the agreements under which the loans were made to the Mexican Corporation (Exs. 53, 57 and 59), Jones, Higgins and Harris expected that the advances required by the corporation would not exceed \$50,000, and had no idea that the advances would exceed \$300,000. They believed that the loans would be repaid prior to the maturity dates of the notes and based on their investigations, available engineering reports and blocked-out ore deposits, such belief was reasonable. The liabilities evidenced by the notes of the Mexican Corporation were agreed to be incurred by Jones, Higgins and Harris in the expectancy that the Mexican Corporation would be successful and pay off the obligations. (Finding XXXIII, R. 63.)

The District Court also found that the loans evidenced by the thirty-two notes charged off by taxpayer in 1948 were consistently treated as loans and debt obligations on the books of taxpayer and on the books of the Mexican Corporation. (Finding XXXIV, R. 63.)

Upon the basis of these findings the lower court concluded as a matter of law, among others, that \$134,555.21 of the net operating loss sustained by taxpayer for its taxable year 1948 was a bad debt allowable as a deduction for 1948 under Section 23 (k) of the Internal Revenue Code, and entitled taxpayer to the refunds claimed by it for 1944, 1946 and 1947 (R. 63-64); that the thirty-two notes of the Mexican Corporation owned

by taxpayer in 1948 constituted debt obligations within the meaning of the Internal Revenue Code, Section 23 (k), became worthless in 1948 to the extent of at least \$134,555.21, and were properly charged off on its books in 1948 in that amount; further, that taxpayer is entitled to recognition for tax purposes as a separate entity distinct from Clayton R. Jones, and that the thirty-two notes in the hands of taxpayer constituted debt obligations and did not represent contributions to capital; and further that the stock ownership of Clayton R. Jones in the Mexican Corporation, or his activities in regard thereto, are not attributable to taxpayer (R. 64); and that in the event they are attributable to taxpayer the fact findings support the court's conclusion that the net operating loss in question was a bad debt allowable for 1948 under Section 23 (k) of the Internal Revenue Code, that the taxes for which refund is sought were excessive, and were illegally and wrongfully withheld from taxpayer, and the Commissioner erred in failing to allow taxpayer's claims for refund (R. 65).

From the adverse judgment of the District Court (R. 66-67) entered upon these findings and conclusions, appellants seek review by this Court.

STATEMENT OF POINTS TO BE URGED

1. That the District Court erred in finding and holding that the taxpayer was entitled to a bad debt deduction of \$134,555.21 in computing its taxable income for the calendar year 1948.

2. That the District Court erred in finding and holding that 32 notes owned by the taxpayer in 1948, identi-

fied as Exhibits 13 to 44, inclusive, constituted debt obligations within the meaning of Section 23 (k) of the Internal Revenue Code.

3. That the District Court erred in finding and holding that taxpayer properly charged off on its books in 1948 as a bad debt the \$134,555.21, as representing the extent to which the 32 notes, Exhibits 13 to 44, inclusive, were then considered worthless.

4. That the District Court erred in finding and holding that the advances evidenced by the 32 notes, Exhibits 13 to 44, inclusive, did not represent contributions to the Mexican corporation's capital by Clayton R. Jones.

5. That the District Court erred in finding and holding that if the stock ownership of Clayton R. Jones in the Mexican corporation or his activities in regard thereto are attributable to the taxpayer, then Findings of Fact XXIII through XXXIV support the District Court's conclusion that \$134,555.21 of taxpayer's \$138,379.48 net operating loss for 1948 was a bad debt, allowable as a deduction for 1948 under Section 23(k) of the Internal Revenue Code.

6. That the District Court erred in finding and holding that the advances made to the Mexican corporation by Clayton R. Jones, evidenced by the 32 notes, Exhibits 13 to 44, inclusive, constituted loans, for income tax purposes, as distinguished from contributions to capital.

7. That the District Court erred in finding and holding that Clayton R. Jones, John C. Higgins and D. E. Harris intended that their advances to the Mexican corporation should constitute loans within the meaning

of the internal revenue laws, as distinguished from contributions to capital.

8. That the District Court erred in finding and holding that the advances made by Clayton R. Jones, John C. Higgins and D. E. Harris to the Mexican corporation created a debtor-creditor relationship within the meaning of the internal revenue laws.

9. That the District Court erred in basing its findings, conclusions and holdings upon the mere formal appearances of the transactions relating to the advances made to the Mexican corporation by Clayton R. Jones, John C. Higgins and D. E. Harris and ignoring the substance of the transactions.

10. That the District Court erred in finding and holding that Clayton R. Jones, John C. Higgins and D. E. Harris expected that their advances to the Mexican corporation would be repaid prior to the maturity dates of the notes issued to cover such advances.

11. That the District Court erred in finding and holding that the taxpayer is entitled to recognition for tax purposes as a separate entity distinct from Clayton R. Jones, insofar as the stock ownership of Clayton R. Jones in the Mexican corporation, and his advances thereto evidenced by notes transferred to the taxpayer, are concerned.

12. That the District Court erred in finding and holding that the advances to the Mexican corporation were not made by the stockholders thereof in direct proportion to their stock interests.

13. That the District Court erred in failing to find and hold that the advances made by Clayton R. Jones, John C. Higgins and D. E. Harris to the Mexican cor-

poration were intended to be, and were in fact in proportion to their stock interests.

14. That the District Court erred in finding and holding that the taxes herein sought to be recovered were excessive and were illegally and wrongfully withheld from taxpayer.

15. That the District Court erred in granting judgment herein in favor of the taxpayer and against the United States and against the Collector, Earle.

16. That the District Court erred in failing to find and hold that the advances made to the Mexican corporation by Clayton R. Jones, John C. Higgins and D. E. Harris were intended to and did constitute contributions to capital of the Mexican corporation.

17. That the District Court erred in failing to enter judgment for the defendants and against the taxpayer.

SUMMARY OF ARGUMENT

The statutory grant of the bad debt deduction is premised upon the establishment by a taxpayer of the existence of the "debts" sought to be deducted, and in applying its terms the first consideration is whether a given taxpayer was in fact owed any debt at all. Furthermore, since taxpayer bases its claim upon a deduction the rule of construction is strict. The bad debt deduction, like other deductions, is a matter of legislative grace and the burden is upon taxpayer to show that the facts bring the case squarely within the terms of the legislative grant. Under this strict standard to escape liability a taxpayer must show clear indebtedness, which taxpayer here plainly failed to establish. On the contrary, the record establishes that the Mexi-

can Corporation was not indebted to taxpayer in the amount, which taxpayer seeks to deduct as a bad debt. The record in main part consists of documentary evidence and undisputed facts, and hence, on review this Court is in as good a position as the trial court to evaluate the evidence, and on settled principles may reject the trial judge's finding and substitute its own.

The circumstance that promissory notes in ordinary form were issued in consideration for the advances is in no sense conclusive. The formal characterization of the advances as loans on the part of the controlling stockholders is not permitted to obscure the true substance of the transaction. Among the undisputed facts which establish that the District Court was clearly in error in reaching its ultimate conclusion of loan, in that the lower court disregarded the substance of the transaction and was persuaded by form alone are the following:

A. The proportionate financial interests of the controlling stockholders, Jones and Higgins, in the Mexican Corporation were substantially the same, whether treated as stockholders or creditors. Indeed, the parties' studied purpose, as evidenced by written agreement made almost at the inception of the enterprise and their testimony at the hearing, was to effect a lending and investing transaction giving so-called creditors, as stockholders, proprietary interest in proportion to their loans.

B. The plan of cloaking what actually were capital contributions, under the guise of loans, was set up under the advice of Mexican counsel, to avoid a recent Mexican statute requiring such operations to be 51% owned

by Mexican citizens. Notes were issued to represent the advances in order to avoid the unfavorable rule of Mexican law, not because they were intended genuinely to create debts. A device resorted to in order to avoid a Mexican law cannot constitute an excuse for depriving the United States of taxes or disguise the true nature of a deduction claim granted under the revenue laws of the United States.

C. Similarly, avoidance of the unfavorable Mexican law and not a purpose to subordinate the finders' interests caused the critical contributions to be represented by so-called notes rather than by preferred stock.

D. Although the notes were formally due two years from date and bore interest, no effort was made to collect them when due, nor was any effort made to collect interest upon them.

E. On liquidation, the stockholders subordinated their claims against the corporation represented by notes to the claims of creditors and treated these securities not like debt, but like capital investment.

F. The part of the Mexican Corporation's financial structure attributed to stock was \$1,000 as against supposed indebtedness to stockholders in excess of \$308,000, or 1 to 308. Even assuming, *arguendo*, that the stock possessed \$50,000 in value, by reason of alleged mining rights, the resulting ratio of investment of \$50,000 to \$308,000 in debt, or more than one to six, in this speculative enterprise, was completely unreal. Thus, the Mexican Corporation's financial structure, in which a wholly inadequate part of the investment was attributed to stock while the bulk was represented by so-called notes to stockholders, was lacking in the sub-

stance necessary for recognition for tax purposes and must be interpreted in accordance with realities.

G. Taxpayer was a mere *alter ego* for Jones and took the notes with complete notice of all the transactions involved and without recourse to him. Jones and members of his family owned all the outstanding stock of taxpayer corporation and its position does not differ from that of the stockholder Jones.

In summary, the court below disregarded substance for form and sustained the wholly useless temporary compliance with statutory literalness which the Supreme Court has condemned as futile.

ARGUMENT

The Advances to the Mexican Corporation, Upon Which Was Founded the Alleged Bad Debt Deduction Claimed by Taxpayer, Constituted Capital Contributions and Not Loans, and Hence Were Not Deductible as Bad Debts Within the Meaning of Section 23 (k) (1) of the Internal Revenue Code

Taxpayer invokes the provisions of Section 23 (k) (1) of the Internal Revenue Code, *supra*, under which Congress has "allowed" as a deduction from gross income—

Debts which become worthless within the taxable year; * * * when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

After giving credit for estimated recovery in the amount of \$8,775, taxpayer contends for and the court below has allowed full deduction of the balance of \$134,555.21 charged off on its books as a bad debt. On

the other hand, the Government contends that taxpayer's investment in the Mexican Corporation did not constitute a loan, but contributions of capital, and, hence, the amount involved was deductible, not in full, but, if at all, at the lesser capital loss rates. (See Internal Revenue Code, Section 117 (26 U.S.C. 1946 ed., Sec. 117) ; R. 45-46, 161-162.)

1. Clearly, the statutory grant of the bad debt deduction is premised upon the establishment by a taxpayer of the existence of the "debt" sought to be deducted. The burden is incumbent upon taxpayer, inherent in the particular statutory foundation of its claim to establish the existence of a "debt".

Taxpayer bases its claim upon a deduction and the bad debt deduction, like other deductions, is a matter of legislative grace. The rule of construction is strict. It does not turn upon general equitable considerations; only if there is clear provision therefor can any particular deduction be allowed. *Equitable Society v. Commissioner*, 321 U.S. 560, 564; *New Colonial Co. v. Helvering*, 292 U.S. 435, 440; *Deputy v. duPont*, 308 U.S. 488, 493; *Brown-Rogers-Dixson Co. v. Commissioner*, 122 F. 2d 347, 350 (C.A. 4th); *Pacific Southwest R. Co. v. Commissioner*, 128 F. 2d 815, 817 (C.A. 9th), certiorari denied, 317 U.S. 663. The burden is upon taxpayer to show that the deduction claimed clearly falls within the terms of the statute, and, thus, includes the burden of proving that there was an "indebtedness". *Commissioner v. Drovers Journal Pub. Co.*, 135 F. 2d 276, 278, 279 (C.A. 7th). In *White v. Commissioner*, 67 F. 2d 726, 728, this Court said:

It is conceded by appellants, as it must be under the authorities, that no deduction from income can be claimed as a matter of right and whatever deduction may be taken is solely a matter of statutory grant. *Lloyd v. Commissioner* (C.C.A.) 55 F. (2d) 842. *The burden is upon the taxpayer to prove that the facts bring the case squarely within the deduction provisions of the statute.* *Burnet v. Houston*, 283 U.S. 223, 51 S. Ct. 413, 75 L. Ed. 991; *Reinecke v. Spalding*, 280 U.S. 227, 50 S. Ct. 96, 74 L. Ed. 385. (Italics supplied.)

See also to this effect *Interstate Transit Lines v. Commissioner*, 319 U.S. 590, 593, and *Boehm v. Commissioner*, 326 U. S. 287, 294, rehearing denied, 326 U. S. 811.

Applying this principle instantly, the taxing statute allows deduction for bad "debts", and taxpayers who seek to take advantage of the legislative grant must show facts squarely bringing them within its terms. Surely this strict standard is not satisfied by the proof of ambiguous and equivocal circumstances, which may be read to point either to investment or to debt. To escape liability taxpayer must show clear indebtedness and it does not comply with this well settled rule, where, as here, the evidence reveals only a hybrid situation, which taxpayer might interpret either way—for stock or for debt—as events transpired and their advantage proved. Certainly, in generously granting the deduction Congress did not intend and the statute should not be misread to subject the amount of tax liability to the substantially untrammelled control of any taxpayer or group of taxpayers.

2. The record establishes the conclusion of the District Court to be clearly erroneous that the Mexican Corporation was indebted to taxpayer in the amount, which taxpayer seeks to deduct as a bad debt. The record in main part consists of documentary evidence and undisputed facts and the findings of the trial court were essentially inferences drawn from such evidence. The oft-cited holding of the Supreme Court in *United States v. Gypsum Co.*, 333 U. S. 364, rehearing denied, 333 U. S. 869, which reversed District Court findings based on evidence of this precise character, is thus here directly applicable. There the Court said (pp. 394-396):

In so far as this finding and others to which we shall refer are inferences drawn from documents or undisputed facts, heretofore described or set out, Rule 52 (a) of the Rules of Civil Procedure is applicable. That rule prescribes that findings of fact in actions tried without a jury "shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses." It was intended, in all actions tried upon the facts without a jury, to make applicable the then prevailing equity practice. Since judicial review of findings of trial courts does not have the statutory or constitutional limitations on judicial review of findings by administrative agencies or by a jury, this Court may reverse findings of fact by a trial court ^{where} ~~were~~ "clearly erroneous." The practice in equity prior to the present Rules of Civil Procedure was that the findings of the trial court, when dependent upon oral testimony

where the candor and credibility of the witnesses would best be judged, had great weight with the appellate court. The findings were never conclusive, however. A finding is "clearly erroneous" when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.

The government relied very largely on documentary exhibits, and called as witnesses many of the authors of the documents. Both on direct and cross-examination counsel were permitted to phrase their questions in extremely leading form, so that the import of the witnesses' testimony was conflicting. On cross-examination most of the witnesses denied that they had acted in concert in securing patent licenses or that they had agreed to do the things which in fact were done. Where such testimony is in conflict with contemporaneous documents we can give it little weight, particularly when the crucial issues involve mixed questions of law and fact. Despite the opportunity of the trial court to appraise the credibility of the witnesses, we cannot under the circumstances of this case rule otherwise than that Finding 118 is clearly erroneous.

Following the *Gypsum* case (and distinguishing *United States v. Yellow Cab Co.*, 338 U.S. 338, on the ground that there the oral testimony was not incompatible with inferences which could reasonably be drawn from the documentary evidence), the Court of Appeals for the Second Circuit, in *Orvis v. Higgins*, 180 F. 2d 537, certiorari denied, 340 U.S. 810, stated

the rule properly applicable to the instant record as follows (pp. 539-540):

Where a trial judge sits without a jury, the rule varies with the character of the evidence: (a) If he decides a fact issue on written evidence alone, we are as able as he to determine credibility, and so we may disregard his finding. (b) Where the evidence is partly oral and the balance is written or deals with undisputed facts, then we may ignore the trial judge's finding and substitute our own, (1) if the written evidence or some undisputed fact renders the credibility of the oral testimony extremely doubtful, or (2) if the trial judge's finding must rest exclusively on the written evidence or the undisputed facts, so that his evaluation of credibility has no significance. (c) But where the evidence supporting his finding as to any fact issue is entirely oral testimony, we may disturb that finding only in the most unusual circumstances.

Under these principles in the cited case, the Court of Appeals rejected the trial judge's finding. So here, the trial court's finding of debt as against loan should be rejected. In view of the undisputed facts and the documentary evidence, this Court is in as good a position as the trial court to evaluate the evidence. Recently, the *Orvis* case has also been quoted and followed by the Court of Appeals for the Seventh Circuit, which, in *Fritz v. Jarecki*, 189 F. 2d 445, reversed an ultimate finding of the District Court and dismissed a taxpayer's complaint.

Indeed, this Court has not hesitated to reverse fact findings (applying Rule 52 (a), Federal Rules of Civil

Procedure, and the rule in the *Gypsum* case), when it was concluded that a mistake had been made by the trial court, and also significantly where the fact issue was one of intent in transferring property, namely, on the one hand, to clear away objections to marriage, or, on the other hand, in contemplation of death. *Gillette's Estate v. Commissioner*, 182 F. 2d 1010. Compare, on the other hand, this Court's decision in *Smyth v. Barneson*, 181 F. 2d 143, affirming the District Court, where, as in the *Yellow Cab* case, oral testimony was not incompatible with undisputed facts and a question of credibility was involved.

Finally, in *Wilshire & West. Sandwiches v. Commissioner*, 175 F. 2d 718, this Court reversed findings of the Tax Court, where the issue was similar to that instantly involved, on the ground that while there were features looking both ways, as to whether advancements in the cited case were loans or stock purchases, those sustaining the conclusion that the transaction was a loan greatly preponderated. See also *United States v. South Georgia Ry. Co.*, 107 F. 2d 3 (C.A. 5th).

3. The circumstance that promissory notes in ordinary form were issued in consideration for the advances is, of course, in no sense conclusive. Thus, it has repeatedly been held that (*In re Fechheimer Fishel Co.*, 212 Fed. 357, 360 (C.A. 2d), certiorari denied, *sub nom. Dellevie v. Fechheimer-Fishel Co.*, 234 U. S. 760)—

the fact that an instrument is called a "bond" is not conclusive as to its character. It is neces-

sary to disregard nomenclature and look to the substance of the thing itself.

The misuse of words of art cannot change the legal conclusions. *Bakers' Mutual Coop. Ass'n v. Commissioner*, 117 F. 2d 27, 28 (C.A. 3d); *Hazel Atlas Glass Co. v. Van Dyk & Reeves*, 8 F. 2d 716, 720 (C.A. 2d), certiorari denied, *sub nom. Van Dyk v. Young*, 269 U. S. 570; *Commissioner v. Smoll Fils Associated*, 110 F. 2d 611, 613 (C.A. 2d); *Brown-Rogers-Dixson Co. v. Commissioner*, *supra*, p. 349.

The parties' formal designation of the advances is surely not decisive, but must yield, when there are facts which even indirectly give rise to inferences contradicting them. *Schnitzer v. Commissioner*, 13 T. C. 43, 60-61, affirmed by this Court on the basis of the Tax Court's opinion, 183 F. 2d 70, certiorari denied, 340 U. S. 911.

4. Among the undisputed facts, which establish that the District Court in reaching its ultimate conclusion of loan, disregarded the substance of the transaction and was persuaded by form alone, are the following:

A. This Court held in *Wilshire & West. Sandwiches v. Commissioner*, *supra*, p. 721:

The effect of a lending and investing transaction giving creditors, as stockholders, proprietary interest in proportion to their loans, subjects the transaction to close scrutiny,

even though, as a matter of law, the transaction need not be regarded as a stock investment, regardless of intent. Yet precisely such a lending and investing

transaction concededly was present and deliberately purposed here. Jones and Higgins completely managed and controlled the Mexican Corporation as well as owned more than 88% of the stock of their alleged debtor. The proportionate financial interests of Jones and Higgins in the Mexican Corporation were substantially the same, whether treated as stockholders or creditors. Indeed, this was the parties' studied purpose, as evidenced by written agreement made almost at the inception of the investment. Exhibit 59 quoted in the Statement, *supra*, an agreement between Jones, Higgins and Harris, made in March, 1945, provided that after setting aside 20% of the stock for the finders (R. 301)—

the remaining eighty per cent (80%) of the stock of said Corporation shall be divided between Clayton R. Jones, John C. Higgins and the above-named members of the Harris family, in proportion to their respective contributions in cash and in equipment, at its reasonable value, and that such stock shall be so distributed when the total of said contributions, as finally made, has been determined.

On cross examination, both Jones and Higgins testified that the agreement was that they should have stock in proportion to advances made. (R. 110, 160.) Moreover, it is additionally significant that the stock was not to be distributed until the total of contributions in cash and equipment, as finally made, should have been determined.

In both respects the agreement was carried out. The advances by Jones and Higgins were substantially

in proportion to stockholdings. To recapitulate the facts already appearing in the Statement, and as set forth in defendants' Exhibit 80, the advances made to the Mexican Corporation, for which it issued notes, and the proportion held by each stockholder-noteholder were as follows (R. 367):

Mina Del Refugio Notes			
Payee	Amount	% <hr/>	
John C. Higgins, Portland, Oregon	\$153,142.44	49.7%	
W. J. Jones & Son, Inc. (By assignment from Clayton R. Jones), Portland, Ore.	121,763.74	39.4%	
Clayton R. Jones, Portland, Ore.	30,472.21	9.9%	49.3%
Dennison E. Harris, Escondido, Calif.	3,000.00	1.0%	
Total notes owing 12/31/48 ..	<u>\$308,378.39</u>	<u>100.0%</u>	

Thus, the total advances by Higgins were \$153,142.44, and by Jones, \$152,235.95. Again, the stock was held in substantially the same proportions. Of the 5,000 shares issued, 2,256 shares or 45.12% were held by Higgins and 2,156 shares or 43.12% were held by Jones. (R. 160, 366.)⁵

Moreover, the agreement (Exhibit 59) was further carried out by the 80% of the stock not being distrib-

⁵ Jones and Higgins eventually acquired more than 80% of the stock, as a result of their purchase of approximately 9% of the stock from one of the finders, A. E. Johnson, Johnson having become ill. (R. 96-97; Ex. 63, R. 315-316.)

The Harris family never advanced more than their original contribution of \$3,000 (Ex. 59, R. 300-301), and eventually received 38 shares or .0075% of the stock, i.e., approximately 1% of the 80% of stock distributed under the terms of Exhibit 59, being substantially in proportion to their contribution to the total advances.

uted until March, 1948, by which time their contributions to the Mexican Corporation had been completed and it could be determined what proportion of contributions were actually advanced by Jones and Higgins, respectively. (R. 160; Ex. 49, R. 241-245, Ex. 80, R. 366.) The mere existence of such an agreement is incompatible with the characterization of the advances as loans or any genuine intention that the advances were to be repaid, and establishes that they in substance all along constituted capital contributions, which were to receive formal recognition through stock ownership, as soon as their proportionate amount was finally determined and, hence, the proportionate proprietorship in the Mexican Corporation bought by the advances could be computed. Subjecting the instant transaction to the close scrutiny required by the cited ruling of this Court, clearly no debt transaction was intended or involved. By the end of 1947 all advances by Jones and Higgins had been completed. (R. 252-254.) By early March, 1948, the likelihood of failure was recognized. (R. 100-101; Ex. 71, R. 331-333.) Thus, as arranged by agreement in advance, the formal issuance and distribution of the stock thereafter in March, 1948, was a mere formal recognition of the proprietary interest which the investments of the previous years (under the guise of loans) had bought in the capital of the Mexican Corporation.

B. That the notes actually represented risk capital and not loans, which the stockholders who made the advances genuinely and reasonably expected would be repaid, clearly appears from the testimony of Higgins, already summarized in the Statement, *supra*. Higgins

recognized that the 5,000 pesos or \$1,000 paid in for the stock was inadequate capital and his first suggestion was to issue more stock. (R. 154, 156.) He testified on recross-examination (R. 156-157):

Q. Then you recognized the \$1,000 you paid in, or the 5,000 pesos, was inadequate capital, didn't you, Mr. Higgins?

A. It was inadequate in the sense that it was not anything like as much money as this company would require to operate, and it was obvious that the company would have to raise money in some other way, by loans or otherwise.

Q. Your first reaction was to issue more stock?

A. To issue more stock, but when he explained the dangers of such operation, under the then current situation under Mexican law, and advised us to put in the money by loans and notes, I accepted his advice and thought it was good advice.

Indeed, the whole plan of cloaking what actually were capital contributions, under the guise of loans was set up under the advice of Mr. Little, the Mexican lawyer, to avoid the recent Mexican statute requiring such operations to be 51% owned by Mexican citizens. (R. 154-156.) Except for this provision of Mexican law, clearly stock would have been issued (and not notes) in consideration for the large sums advanced by the stockholders as original capital to place the enterprise into operation and to purchase the mine from the owners. The stockholders were merely investing the amounts at the risk of the business; any inference that they genuinely intended the amounts to be repaid absolutely and in any event surely is clearly wrong. Notes were issued

to represent the advances to avoid the unfavorable rule of Mexican law, not because they were intended genuinely to create debts. No one dealing with such a speculative enterprise at arm's length would ever under like circumstances have loaned this money on unsecured notes or expected it to be repaid in any event within a definite two year period plus interest (or at all). It was clearly wrong for the trial court to find that these stockholders made their contributions with any such expectation.

Surely, there is no warrant for permitting a device, indisputably resorted to in order to avoid a Mexican law, to be employed as an excuse for depriving the United States of taxes or to disguise the true nature of a deduction claim, granted under the revenue laws of the United States by Congress as a matter of legislative grace and where the rule of construction is strict.

C. Higgins' testimony in this connection also plainly refutes taxpayer's argument that the advances were made by way of loans, because he and Jones did not want the finders to participate in the cash that he and Jones had advanced. Obviously the issuance of preferred stock to Higgins and Jones would have genuinely represented the transaction and afforded them the protection necessary as against the finders. Indeed, Higgins made this suggestion at the outset, but Mr. Little, on account of the same Mexican law, advised the stockholders to express their investment under the form of loans. (R. 155-157.)

Exhibit 59 again discloses the true nature of the transaction, both by its provision that stock ownership,

i.e., proprietary interest, was to be geared upon the so-called loans, and also by its frank language (R. 301)—

that all of the *contributions* of said parties, except the amount thereof required to pay up the 5,000 pesos capital stock of said corporation, shall be *regarded* as loans to said corporation, * * *. (Italics supplied.)

The further provision of Exhibit 59 that the “notes shall be payable either at or before their maturity, before any dividends shall be declared” (R. 301-302) again places the notes in a position of redeemable preferred stock rather than genuine debt and indicates that the “notes” were expected to be redeemed, like stock, out of earnings. Thus, it was again avoidance of an unfavorable Mexican law and not subordination of the finders’ interests, that caused the critical contributions to be represented by so-called notes and not by preferred stock.

D. Although the notes were formally due two years from date and bore interest, no effort was made to collect them when due, nor was any effort made to collect interest upon them. Nevertheless, as appears from footnote 2, *supra*, at least twenty of Jones’ notes fell “due” before or by the end of 1947 (Exs. 13-32), and during a period when high hopes were felt for the success of the venture. Undoubtedly, an equal part of Higgins’ notes fell due during the same period. Had these obligations any reality as debt, or had there existed any real intent or expectation that payments should be made on the due dates, it is inconceivable that no claim would have been asserted or effort made to ob-

tain payment either of interest or of principal of any of them. Again, during part of this period (i.e., from November, 1946, to the end of 1947), at a time when the earlier notes were already falling due and without any pretense being made towards payment, Jones and Higgins were, nevertheless, making further contributions and receiving additional notes purportedly to be paid with interest in two years from date. Clearly no one reasonably could have expected the latter notes to be paid on their due dates any more than the earlier ones had been. Thus, the record indisputably discloses that the stated two year maturity dates of the loans lacked genuineness and reality. At all times the parties were merely placing their advances at the risk of the business.

E. Indeed, when the transaction was in the course of being wound up, the stockholders treated the so-called notes as subordinate obligations of the Mexican Corporation, not as they pretended to be, first obligations. Thus, as appears in the Statement, *supra*, the liquidating agreement between the engineer at the mine and the Mexican Corporation provided that before the proceeds of the sale of machinery and equipment was to be transferred to the Corporation, "all of the Company's outstanding accounts, pay rolls and liabilities" (Ex. 75, R. 345) were to be satisfied. Again, the corporate resolution, which provided for pro rata distribution to the holders of the notes of funds realized under this liquidating agreement and any other funds of the company provided that such funds were to be distributed "after payment of all prior liabilities." (Ex. 76, R. 353.) Thus, on liquidation the stockholders subordi-

nated their claims against the corporation represented by notes to the claims of creditors, and treated these securities not like debt, but like capital investment.

F. In *Schnitzer v. Commissioner*, *supra*, the Tax Court, in its opinion which, as already noted, formed the basis for this Court's affirmance, said (13 T.C. 43, 62):

A corporation's financial structure in which a wholly inadequate part of the investment is attributed to stock while the bulk is represented by bonds or other evidence of indebtedness to stockholders is lacking in the substance necessary for recognition for tax purposes, and must be interpreted in accordance with realities.

Instantly, the part of the Mexican Corporation's financial structure attributed to stock was \$1,000 as against supposed indebtedness to stockholders in excess of \$308,000, or 1 to 308. The owners of a business should have as much or more in it than the creditors. Especially is this true of an enterprise which is so speculative as to be characterized by Higgins as "gambling". (R. 152.) As to the claim made at the hearing that the stock of the Mexican Corporation possessed value by way of "mining rights", there is little evidentiary basis for the \$50,000 value stated by Jones. (R. 107.) There was also evidence of sales by the finder, Kroder, of 9% of the stock in April, 1945, for \$5,000, and by co-finder, Johnson, of 9% in March, 1946, for \$4,000. (R. 96-97; Ex. 60, R. 302-303; Ex. 63, R. 315-316.)

As a matter of fact, the valuation of the so-called mining rights as part of the original value of the stock

was apparently an after-thought. Certainly, the agreement (Ex. 59) pursuant to which the stock actually was distributed in proportion to other advances made to the corporation (R. 301) did not afford consideration of any value in the stock in addition to the 5,000 pesos or \$1,000 paid in. If any real additional value was supposed to exist in the stock, it appears quite unlikely that the entire proprietary interest would have been geared exclusively on the future advances and to be determined after completion of the advances.

However, assuming, *arguendo*, that the stock possessed \$50,000 in value, surely the resulting ratio of investment of \$50,000 to \$308,000 in debt, or more than one to six, of capital stock to indebtedness in this highly speculative enterprise, is completely unreal.

The instant situation is that of "an obviously excessive debt structure", adverted to by the Supreme Court in *John Kelley Co. v. Commissioner*, 326 U.S. 521, 526, as follows:

As material amounts of capital were invested in stock, we need not consider the effect of extreme situations such as nominal stock investments and an obviously excessive debt structure.

With respect to a similar situation the Court of Appeals for the Fifth Circuit in *Arnold v. Phillips*, 117 F. 2d 497, certiorari denied, 313 U. S. 583, held as follows (p. 501):

Those [advances] made before the enterprise was launched were, as the district court found, really capital. Although the charter provided for no more capital than \$50,000, what it took to build the plant and equip it was a permanent investment, in

its nature capital. There was no security asked or given. Arnold saw that he could not proceed with his enterprise unless he enlarged the capital. There can be little doubt that what he contributed to the plant was actually intended to be capital, notwithstanding the charter was not amended and demand notes were taken. The district court was justified in concluding as a matter of fact that the advances during the first year were capital, a sort of interest-bearing redeemable stock; and that as a matter of law these contributions could not, as against corporate creditors, either precedent or subsequent, be turned into secured debts by afterwards taking and recording a trust deed to secure them. *There was no debt to be secured.* (Italics supplied.)

While the cited case arose in a bankruptcy situation, it is notable that the holding of the court is placed upon the broad ground, irrelevant to bankruptcy, that "There was no debt to be secured." Here also substantially all the stockholders' advances were invested in purchase of the mines, plant, equipment and development, namely, original permanent capital investment. (Ex. 51, R. 247-252.)

Again, in a case where the attributes of legal form were far more fully complied with than in the instant record, the Tax Court in *1432 Broadway Corp. v. Commissioner*, 4 T. C. 1158, 1164-1165, said:

The debentures are in approved legal form, and, if their legal attributes alone were determinative of the character of the interest accruals, there would be little room for doubt that they were the indebtedness they purport to be. Cf. *Clyde Bacon, Inc.*, 4 T. C. 1107. But, for tax purposes, their conformity to legal forms is not conclusive. Although

a taxpayer has the right to cast his transactions in such form as he chooses, and the form he chooses will generally be respected, the Government is not required to acquiesce in the taxpayer's election of form as necessarily indicating the character of the transaction upon which his tax is to be determined. "The Government may look at actualities and upon determinaiton that the form employed for doing business or carrying out the challenged tax event is unreal or a sham may sustain or disregard the effect of the fiction as best serves the purposes of the tax statute." *Higgins v. Smith*, 308 U. S. 473. See also *Commissioner v. Court Holding Co.*, 324 U. S. 331. The Government is not bound to recognize as the substance or character of a transaction a technically elegant arrangement which a lawyer's ingenuity has devised. *Griffiths v. Commissioner*, 308 U. S. 355.

The cited case was affirmed by the Court of Appeals for the Second Circuit in 160 F. 2d 885, where it was pointed out that the Tax Court had "denied deduction on the ground that the evidence did not show that 'the debentures were, or were intended to be, evidences of indebtedness'; they were 'more nearly like preferred stock than indebtedness'." While the Court of Appeals, in view of the *John Kelley* case, *supra*, regarded these conclusions as not within the scope of its judicial review, it further stated:

We may add, however, that, if the question were open to us, we should reach the same result as did the Tax Court.

See also to the same effect *Thomas v. Commissioner*, 2 T. C. 193; *Janeway v. Commissioner*, 2 T. C. 197, affirmed, 147 F. 2d 602 (C. A. 2d); *Swoby Corp. v. Com-*

missioner, 9 T. C. 887; Semel, Tax Consequences of Inadequate Capitalization, 48 Columbia L. Rev. 202 (March, 1948); Semel, Loan Versus Investment—Inadequate Capitalization, 5 Tax L. Rev. 424 (March, 1950).

Following the *Schnitzer* case, *Dobkin v. Commissioner*, 15 T. C. 31, affirmed by the Court of Appeals for the Second Circuit on the opinion of the Tax Court, 192 F. 2d 392, held advances were risk capital and not deductible as bad debts. In its opinion, the Tax Court, considering *inter alia* inadequate capitalization, notwithstanding that there so-called interest was paid on the alleged loans, said (p. 33):

When the organizers of a new enterprise arbitrarily designate as loans the major portion of the funds they lay out in order to get the business established and under way, a strong inference arises that the entire amount paid in is a contribution to the corporation's capital and is placed at risk in the business. *Coker v. Commissioner*, 148 Fed. (2d) 336; *Joseph B. Thomas*, 2 T. C. 193. The formal characterization as loans on the part of the controlling stockholders may be a relevant factor but it should not be permitted to obscure the true substance of the transaction. *Sam Schnitzer*, 13 T. C. 43, 60.

So also are the rulings in the recent cases of *Bair v. Commissioner*, 16 T. C. 90, 99, pending on appeal (C. A. 2d), and of *Matthiessen v. Commissioner*, 16 T. C. 781, 785-786, affirmed (C. A. 2d), February 15, 1952 (1952 C.C.H., par. 9201).

G. In *John Kelley Co. v. Commissioner*, *supra*, pp. 525-526, the Court there said:

There is not present in either situation the wholly useless temporary compliance with statutory literalness which this Court condemned as futile, as a matter of law, in *Gregory v. Helvering*, 293 U. S. 465. The demonstrated possibility of sales by the holders of the obligations to persons other than stockholders alone proves the differentiation.

On the other hand, here it is submitted that there was the wholly useless temporary compliance with statutory literalness. With its nominal capitalization the Mexican Corporation could not have borrowed \$308,000 on its unsecured notes in any arm's length transaction. The controlling stockholders gauged their proprietary interest on the amount of the advances; they never could have expected the amounts to be repaid in any event; indeed, they never sought their repayment as they fell due and were merely placing their contributions at the risk of the business. Indeed, indisputably they would not even have adopted the form of debt to represent the advances, except to avoid an unfavorable Mexican law.

But taxpayer corporation claims that it was not a stockholder of the Mexican Corporation, that the notes were sold to it for value, and in any event, this should constitute a differentiation. It is true that Jones sold the "notes" to taxpayer at their face value but, without recourse. (R. 92.) However, taxpayer was a mere *alter ego* for Jones and took with complete notice of all of the transactions involved. As appears from the Statement, *supra*, contributions made by Jones to the Mexican Corporation had been made by withdrawing funds from taxpayer corporation. (R. 92-93, 104-105.) Further, Jones and members of his family owned all the

outstanding stock of taxpayer corporation (R. 104), of which Jones personally owned from 47% to 59% between 1945 and 1948 (R. 109; Deft. Ex. 80, R. 364). Here is no case, such as is contemplated in *John Kelley Co., supra*, where obligations are sold to third parties at arm's length without notice. Clearly, if a security, actually risk capital in the hands of the original subscriber, can be transformed into a debt obligation by the mere formality of transfer without recourse to a wholly controlled family corporation, and a tax deduction thereby obtained, the intent of Congress would most facilely and flagrantly be obviated, and the statute nullified by mere passing of papers. Such a disregard of substance for form surely finds no place in a case where strict construction is the rule and the burden is upon the taxpayer to prove that the facts bring the case squarely within the deduction provisions of the statute.

CONCLUSION

For the reasons above given, the judgment of the District Court is erroneous and should be reversed.

Respectfully submitted,

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MARCH, 1952.

United States
COURT OF APPEALS
for the Ninth Circuit

HUGH H. EARLE, Collector of Internal Revenue
for the District of Oregon,

Appellant,

v.

W. J. JONES & SON, INC., a Corporation,

Appellee.

UNITED STATES OF AMERICA,

Appellant,

v.

W. J. JONES & SON, INC., a Corporation,

Appellee.

On Appeals from the United States District Court for the
District of Oregon.

BRIEF OF APPELLEE

FILED

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BRIEF OF APPELLEE

OPINION BELOW

The District Court rendered no opinion; its Findings
of Fact and Conclusions of Law are set forth at R. 52-66.

JURISDICTION

Appellee taxpayer, an Oregon corporation maintaining its principal office in Portland, Oregon, filed with the Collector of Internal Revenue for the District of Oregon claims for refund of 1944 federal excess profits taxes and 1946 and 1947 federal income taxes (Exhibits* 6, 7, 8, R. 172-184). Such refunds result from the carry back of a net operating loss disclosed in the 1948 income tax return filed by taxpayer on or about March 15, 1949, with the Collector of Internal Revenue for the District of Oregon (R. 54). The refund claims were filed on November 4, 1949 (R. 55-56), within the time allowed by I.R.C.† Section 322 as required by I.R.C. Section 3772 (a)(1). No notices of allowance or disallowance of the refund claims were received by taxpayer under I.R.C. Section 3772. Within the period permitted by I.R.C. Section 3772 (a)(2) taxpayer on September 27, 1950, brought two actions on the claims in the United States District Court for the District of Oregon.

One such action (R. 5-14) was brought against Hugh H. Earle, present Collector of Internal Revenue for the District of Oregon, for recovery of the portion of the taxes collected by him. Jurisdiction of the District Court over this action exists by virtue of 28 U.S.C., Section 1340.

The other such action (R. 18-23) was brought against the United States of America for recovery of the portion

*All the exhibits referred to in this brief are plaintiff's exhibits.

†The reference I.R.C. used in this brief means Internal Revenue Code.

of the taxes collected by a Collector of Internal Revenue who was not in office as such collector when the action was commenced. Jurisdiction of the District Court over this action exists by virtue of 28 U.S.C., Section 1346 (a)(1).

By consent of the parties and approval of the court, the two actions were consolidated and tried together without a jury. On June 12, 1951, a single judgment in favor of taxpayer was entered in both actions by the District Court for the District of Oregon (R. 66-67). Notices of appeal from such judgment were filed by the Collector and the United States on August 8, 1951 (R. 67-69). Jurisdiction of this Court to hear this appeal is conferred by 28 U.S.C., Sections 1291 and 1294.

QUESTION PRESENTED

Whether or not the District Court was clearly erroneous in concluding that 32 promissory notes of a Mexican corporation owned by taxpayer in 1948 were what they purported to be, and constituted debt obligations within the meaning of I.R.C. Section 23 (k).

If such notes were debt obligations, rather than evidence of contributions to capital, appellants do not question that taxpayer should be allowed a bad debt deduction of \$134,555.21 for 1948,* and appellants concede (R.

*In appellants' brief the "Question Presented" is limited to whether the notes represented debts or contributions to capital. If the notes were debt obligations, appellants do not contest that the notes became worthless in 1948 to the extent claimed, or that the notes had an adjusted basis to taxpayer sufficient to justify the deduction in the amount claimed.

46) that such bad debt deduction entitles taxpayer to the claimed net operating loss for 1948 and to the claimed refunds for 1944, 1946 and 1947.

STATUTE

The basis of the controversy is I.R.C. Section 23 (k), the pertinent portion of which reads as follows:

“SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(k) Bad Debts.—

- (1) *General Rule.* — Debts which become worthless within the taxable year; . . . and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction”

STATEMENT

While the actions technically involve refunds of excess profits taxes for 1944 and income taxes for 1946 and 1947, the basis of the controversy is a 1948 bad debt deduction in the sum of \$134,555.21 claimed by taxpayer as the major portion of a \$138,379.48 net operating loss disclosed on its 1948 income tax return. If such 1948 bad debt deduction is allowable, taxpayer is entitled to the 1944, 1946 and 1947 refunds claimed by it.

The District Court held that the bad debt deduction

is allowable. A concise statement of the case is contained in Findings of Fact XII through XXXIV made by the District Court as the basis for its decision in favor of taxpayer. The statements below are substantially direct quotations from these findings of the District Court, and for the purposes of this brief such findings are divided into two categories herein referred to as "Primary Facts" (Findings XII through XXII) and "Supplemental Facts" (Findings XXIII through XXXIV):

Primary Facts (R. 56-59):

During the year 1948 taxpayer was the unqualified holder and owner of 32 promissory notes in the aggregate principal amount of \$121,763.74, duly issued by Mina del Refugio, S. A., a corporation duly organized and existing under and by virtue of the laws of Mexico (hereinafter referred to as the "Mexican Corporation").

On or about August 31, 1946, taxpayer received 28 of said 32 notes from Clayton R. Jones for a valuable consideration equal to the aggregate principal amount of \$102,930.96, plus \$4,654.57 accrued interest thereon to August 31, 1946. The remaining four of the 32 notes were received by taxpayer from Clayton R. Jones on December 31, 1946, for a valuable consideration equal to their aggregate principal amount of \$18,832.78, making a total consideration of \$126,418.31 paid by taxpayer for the 32 notes. Appellants admitted and the District Court found that the 32 notes were acquired by taxpayer for a valuable consideration.

When the 32 notes were received by taxpayer on August 31, 1946, and December 31, 1946, for the ag-

gregate consideration of \$126,418.31, the notes were reasonably worth such consideration paid for same, and taxpayer and the officers of the Mexican corporation fully expected that the notes and interest would be fully paid.

After receipt of the notes from Clayton R. Jones, taxpayer accrued interest on the notes in the sum of \$2,300.22 for 1946, \$7,305.84 for 1947 and \$7,305.84 for 1948 making total accrued interest of \$16,911.90. Such accrued interest was reflected in taxpayer's net income for federal income tax purposes for the subject years. The \$16,911.90 in accrued interest, plus the aforementioned aggregate consideration of \$126,418.31, made a total of \$143,330.21 which taxpayer paid or accrued for the 32 notes.

The Board of Directors of the Mexican Corporation duly held a meeting on December 27, 1948, at which the board ratified the termination of all operations of the Mexican Corporation, confirmed the sale of all its equipment and further directed the immediate abandonment of all real property, mining claims and other assets. At such meeting the directors determined that no more than \$22,500.00 could be salvaged from all of the corporate assets.

The 32 notes were worthless in 1948 to the extent of \$134,555.21, said amount being the difference between \$143,330.21 (the consideration paid and accrued by taxpayer for the notes) and \$8,775.00 (the maximum amount which taxpayer could expect to recover on the notes); and on December 31, 1948, taxpayer properly

charged the notes off on its books in the sum of \$134,555.21 by (a) debiting "bad debts" in the amount of \$143,330.21, (b) crediting "notes receivable" in the amount of \$121,763.74, (c) crediting "interest" in the sum of \$21,566.47, and (d) setting up on its books \$8,775.00 as the estimated amount of recovery on the notes. The amount actually received by taxpayer on the notes subsequent to such charge-off was \$8,694.42, which is \$80.58 less than the \$8,775.00 estimated recovery.

The 32 notes charged off by taxpayer in 1948 were not worthless prior to 1948.

At no time during 1948 nor at any other time did taxpayer own any capital stock or any other equity interest in the Mexican Corporation.

Taxpayer's accounting period is the calendar year and taxpayer keeps its books on the accrual basis.

Supplemental Facts

Clayton R. Jones made loans to the Mexican Corporation evidenced by notes duly issued for a valuable consideration, and 32 of the notes so issued to Clayton R. Jones were the 32 notes assigned by him to taxpayer for value on August 31, 1946, and December 31, 1946.

In addition to the loans to the Mexican Corporation made by Clayton R. Jones, loans were made by John C. Higgins and D. E. Harris, which loans were also evidenced by notes duly issued by the Mexican Corporation for a valuable consideration. Advances in the aggregate sum of \$308,378.39 were made by Clayton R. Jones,

John C. Higgins and D. E. Harris, which advances were evidenced by notes duly made, executed and delivered by the Mexican Corporation (including the 32 notes assigned by Clayton R. Jones to taxpayer for value). At the time of making such advances Jones, Higgins and Harris intended that the advances should constitute loans and create a debtor-creditor relationship, and all subsequent actions of Jones, Higgins and Harris in regard to said advances (and the notes evidencing same) have been consistent with such intention that the advances constituted loans and created a debtor-creditor relationship.

Jones, Higgins and Harris acquired the Mexican Corporation for the purpose of exploiting certain gold and silver mining rights having a substantial value obtained by Jones, Higgins and Harris as individuals from two finders named Daniel D. Kroder and Arthur E. Johnson. Pursuant to an agreement dated July 31, 1944 (Exhibit 53, R. 258), Kroder was to receive a one-third stock interest in the Mexican Corporation as a finder's fee for procuring such mining rights for Jones, Higgins and Harris, which interest was later reduced to a 20 per cent stock interest to Kroder and his associate Johnson (10% to each) under a supplemental agreement of August 31, 1944 (Exhibit 54, R. 262). Kroder and Johnson never made any advances or contributions to the Mexican Corporation. The 80 per cent balance of the capital stock of the Mexican Corporation was owned by Jones, Higgins and Harris.

The mining rights acquired by Jones, Higgins and Harris from Kroder and Johnson were transferred by

Jones, Higgins and Harris to the Mexican Corporation through the execution of an option and lease agreement dated October 31, 1944, in the name of the Mexican Corporation (Exhibit 56, R. 269). The mining rights at the time of such transfer to the Mexican Corporation had a very substantial value in excess of the amount payable under said option and lease agreement, and such transfer of the mining rights to the Mexican Corporation by Jones, Higgins and Harris constituted contributions to the capital of the Mexican Corporation.

In the spring of 1945 a third person, Walter M. Wells, and his associates paid \$5,000 for the 10 per cent stock interest of Kroder in the Mexican Corporation, and in March, 1946, Jones and Higgins paid \$4,000 for the 9 per cent stock interest of Johnson in the Mexican Corporation (Johnson previously having transferred a one per cent interest to an associate of Wells). The asset accounting for such value of the stock was the excess in the value of said mining rights over the amounts payable under the option and lease agreement.

Whether or not the transfer of said mining rights by Jones, Higgins and Harris to the Mexican Corporation constituted contributions to capital, the advances made by Jones, Higgins and Harris to the Mexican Corporation evidenced by the notes duly issued by the Mexican Corporation (including the 32 notes in question) were intended to constitute and did constitute, loans rather than contributions to capital.

The advances to the Mexican Corporation were not made by the stockholders thereof in direct proportion

to their stock ownership because Kroder and Johnson owned 20 per cent of the capital stock but made no advances whatsoever to the corporation.

There were business reasons why Jones, Higgins and Harris intended that their advances to the Mexican Corporation should constitute loans, in that they desired to be repaid such advances before anything was received by or accrued to the finders (Kroder and Johnson), who paid nothing for their 20 per cent stock interest, and they desired to be in as strong a position as possible in the event that the Mexican authorities or general creditors made claims against the corporation.

At the time of the execution of the agreements under which the loans were made to the Mexican Corporation (Exhibits 53, 57, 59, R. 258, 290, 300), Jones, Higgins and Harris expected that the advances required by the corporation would not exceed \$50,000, and had no idea that the advances would exceed \$300,000. They believed that the loans would be repaid prior to the maturity dates of the notes issued for such loans, and based on their investigations, available engineering reports and blocked-out ore deposits, such belief was reasonable. The liabilities evidenced by the notes of the Mexican Corporation were agreed to be incurred by Jones, Higgins and Harris in the expectancy that the Mexican Corporation would be successful and pay off the obligations.

The loans evidenced by the 32 notes charged off by taxpayer in 1948 were consistently treated as loans and debt obligation on the books of taxpayer and on the books of the Mexican Corporation.

SUMMARY OF ARGUMENT

The conclusion of the District Court that the 32 notes constituted debt obligations should be sustained inasmuch as such conclusion, for the reasons herein mentioned, is far from "clearly erroneous".

The 32 notes of the Mexican Corporation constituted debt obligations in the hands of taxpayer and did not represent contributions to capital because, (i) said notes were in the form of unconditional debt obligations, and (ii) taxpayer did not have or own an interest in the capital stock of the Mexican Corporation. Taxpayer is entitled to recognition for tax purposes as a separate entity distinct from Clayton R. Jones, who assigned the 32 notes to taxpayer for a valuable consideration, and the stock ownership of Clayton R. Jones in the Mexican Corporation, or his activities in regard thereto, are not attributable to taxpayer.

The preceding paragraph is substantially a direct quotation from Conclusion of Law IV of the District Court (R. 64), minus the portion thereof which is not in issue on this appeal. It is taxpayer's contention that the District Court's Findings of Fact XII through XXII (set forth in this brief under the heading "Primary Facts") substantiate such conclusion and are sufficient in themselves to support the bad debt deduction.

If the stock ownership of Clayton R. Jones in the Mexican Corporation, or his activities in regard thereto, are attributable to taxpayer, then Findings of Fact XXIII through XXXIV of the District Court (set forth

in this brief under the heading "Supplemental Facts") support the conclusion that the notes of the Mexican Corporation constituted debt obligations justifying taxpayer's 1948 bad debt deduction.

The preceding paragraph is in essence a direct quotation from Conclusion of Law V of the District Court (R. 65).

ARGUMENT

I. The Conclusion of the District Court Should Be Sustained Unless Clearly Erroneous.

The findings of fact of the District Court are entitled to finality unless clearly erroneous. This proposition is set forth in the argument and authorities contained in the Commissioner's (respondent's) brief in the case of *Schnitzer v. Commissioner*, 183 F. 2d 70 (C.C.A. 9th, 1950) affirming 13 T.C. 43, wherein the Commissioner contended that the findings of the Tax Court should be sustained although based upon a conflict between documentary evidence and oral testimony. The following are pertinent extracts from this brief (pp. 22 and 25-27):

"Such fact questions [concerning the existence of a debt] are primarily for determination by the trier of the facts, instantly, the Tax Court, and its factual findings here sustaining the Commissioner's determination are entitled to finality 'unless clearly erroneous'. Rule 52(a), Federal Rules of Civil Procedure. *Grace Bros. v. Commissioner*, 173 F. 2d. 170 (C.A. 9th); *Joe Balestrieri & Co. v. Commis-*

sioner, 177 F. 2d 867 (C.A. 9th); *Smyth v. Commissioner*, (C.A. 9th), decided April 5, 1950 (1950 C.C.H., par. 9267).

“ . . . This testimony as to intent was carefully considered by the Tax Court, which saw the witnesses and observed their demeanor, candor and credibility under examination, and which also carefully found and appraised the many documentary exhibits and other record facts and inferences arising from such facts. On established principles, already adverted to . . . such weighing and analysis of the evidence was properly and primarily within the province of the fact finder. Taxpayers are not entitled, as they appear to think, to come to this Court for what virtually would amount to a trial *de novo* on the record of such a finding as intent. So the Supreme Court recently held, in *United States v. Yellow Cab Co.*, 338 U.S. 338, 340-342, where *inter alia*, it is said (p. 341):

‘Findings as to the design, motive and *intent* with which men act *depend peculiarly* upon the credit given to witnesses by those who see and hear them.’ (Italics supplied.)

“The Tax Court was warranted on the highest authority to afford little weight to such testimony in conflict with contemporaneous documents. *United States v. Gypsum Co.*, 333 U.S. 364, 396, rehearing denied, 333 U.S. 869.

“The Tax Court did not err in declining to accept testimony of interested or friendly witnesses in the nature of general statements, unsupported by contemporary acts and documents, and which in the light of the entire record might reasonably be regarded as inherently improbable. *Greenfield v. Commissioner*, *supra*; *Grace Bros. v. Commissioner*, *supra*; *Joe Balestrieri & Co. v. Commissioner*, *supra*. As the Supreme Court has only recently held, in *United States v. National Association of Real Estate Boards*, decided May 8, 1950:

'It is not enough that we might give the facts another construction, resolve the ambiguities differently, and find a more sinister cast to actions which the District Court apparently deemed innocent. See *United States v. Yellow Cab Co.*, 338 U.S. 338, 342; *United States v. Gypsum Co.*, 333 U.S. 364, 394-395. We are not given those choices, because our mandate is not to set aside findings of fact "unless clearly erroneous'."

If this Court had no cause to disturb the trial court's decision in the *Schnitzer* case involving a conflict between evidence and testimony, then certainly this Court should not disturb the conclusion of the District Court in the instant case where there is no conflict in evidence or testimony.

It is difficult to understand why the law presented in appellants' brief (Br. 36-39) should differ so greatly from the above statement of the law contained in the brief of the Commissioner in the *Schnitzer* case. Since this Court in a *per curiam* decision affirmed the trial court in the *Schnitzer* case, it would seem that the correct statement of the law is contained in the portion of the Commissioner's brief quoted above, rather than in appellants' brief. Therefore, the conclusion of the District Court should be sustained inasmuch as such conclusion, for the reasons hereinafter discussed, is far from "clearly erroneous," if in fact it is not the only conclusion which can properly be derived from the record.

II. Primary Argument that Record Sustains Conclusion of District Court.

- A. The 32 notes of the Mexican Corporation constituted debt obligations in the hands of taxpayer and did not represent contributions to capital because, (i) the notes were in the form of unconditional debt obligations and, (ii) taxpayer did not have or own any interest in the capital stock of the Mexican Corporation.**

The 32 notes of the Mexican Corporation were in the ordinary form of promissory notes, payable 2 years after date, together with interest at 6 per cent per annum. Such notes contained no qualifications or restrictions whatsoever. They were duly issued by the Mexican Corporation pursuant to authority conferred by its board of directors at a meeting held on November 20, 1944.

Appellants contend that the 32 notes are not really notes and do not constitute debt obligations within the meaning of I.R.C. Section 23 (k). This contention seems to be based on the fact that the Mexican Corporation issued its notes in proportion to the stockholdings of the promisees, and on the Mexican Corporation's ratio of debt to capital stock.

These factors relied upon by appellants may be pertinent when the taxpayer claiming the bad debt deduction owns stock in the debtor corporation, in addition to the alleged debt obligations, but such factors have no applicability where the taxpayer owns no stock in the debtor. When the holder of alleged debt obligations also owns stock in the debtor corporation, it may be appro-

priate, in certain instances, to regard the purported debt obligations as a mere augmentation of the stock or equity interest, and to treat the total interest of the taxpayer as a stock or equity interest for tax purposes. On the other hand, if the holder of the debt obligations owns no stock in the debtor corporation, there is no stock interest to be augmented, and the debt obligations alone cannot be regarded as constituting a stock interest inasmuch as the holder of the obligations possesses none of the attributes of a stockholder.

The foregoing distinction is borne out by the authorities. In ever bad debt case cited by appellants, the taxpayer owned stock in the debtor corporation in addition to the debt forming the basis for the claimed bad debt deduction. In the instant case, no stock of the Mexican Corporation was owned by taxpayer. The only interest of taxpayer in the Mexican Corporation was that conferred by the 32 notes. Such notes gave taxpayer none of the attributes of a stockholder, so taxpayer's interest in the Mexican Corporation cannot logically be regarded as a stock interest.

In short, where the holder of purported debt obligations also owns stock in the debtor corporation, a question may exist as to whether the stock interest dominates the creditor interest for tax purposes, but no such question is presented where the holder of the obligations owns no stock interest whatsoever in the debtor corporation.

- B. Taxpayer is entitled to recognition for tax purposes as a separate entity distinct from Clayton R. Jones who assigned the 32 notes to taxpayer for a valuable consideration, and the stock ownership of Clayton R. Jones in the Mexican Corporation, or his activities in regard thereto, are not attributable to taxpayer.**

Appellants' answer to taxpayer's primary argument (under A above) is that the corporate entity of taxpayer should be disregarded, that taxpayer was a mere alter ego of Clayton R. Jones and took the notes with complete notice of all the transactions involved. No authority is cited by appellants for this rather startling contention. For many years taxpayer has been actively engaged in the stevedoring business and has been consistently recognized as a separate taxable entity by the government. While taxpayer should be entitled to recognition as a separate entity even if Clayton R. Jones owned all the stock of taxpayer, any doubt on the subject is dispelled by the fact that Clayton R. Jones owned less than a majority of the stock of taxpayer during 1946, 1947 and 1948 (R. 109).

The fact that taxpayer took the notes with notice of all the transactions seems immaterial. Notice may be important in determining whether the holder of a note is a holder in due course under the negotiable instrument laws, but I.R.C. Section 23 (k) is not limited to holders in due course. Notice has nothing to do with whether an instrument does or does not evidence a debt. Notice of the transactions did not give taxpayer any of the attributes of a stockholder, so such notice could not have converted taxpayer's interest represented by the 32 notes into a stock or equity interest.

The validity of taxpayer's basic argument is substantiated by a decision of the Tax Court, and the Tax Court reputedly takes a strict view as to what constitutes a debt. Practically all of the cases denying bad debt or interest deductions originated in the Tax Court, and in the case of *Wilshire & West, Sandwiches v. Commissioner*, 175 F. 2d 718, this Court found it necessary to reverse the Tax Court because of its overstrict approach to the question. Nevertheless, when faced with a situation similar to that here involved, the Tax Court, in the case of *Washington Institute of Technology, Inc.*, P-H T.C. Memo. Dec. Par. 51,001 (1951), readily allowed the claimed bad debt deduction.

All of the stock of the taxpayer corporation in the *Washington Institute* case was owned by X, an individual. For the purpose of exploiting an exclusive license agreement X formed a new corporation and transferred the license agreement to it in return for all the capital stock. No working capital was provided the new corporation by X individually, and all of the new corporation's operations were financed by advances from the taxpayer corporation. The Tax Court held (1951 P-H Memo. Dec. p. 7):

"The record does not substantiate respondent's contention that these advances were contributions to capital and not loans. The debtor and petitioner were separate and distinct corporations, each organized to carry on specific unrelated business. Petitioner received no stock nor evidence of ownership in the debtor corporation in return for the advances . . . "

It is to be noted that the Tax Court was not per-

turbed by the fact that the only contribution to the capital of the debtor corporation made by X was the license agreement to which the Court attributed no value. The fact that the corporation issued stock having an aggregate par value of \$100,000 for the agreement does not mean it had such value. The court specifically found that, other than the license agreement, nothing was contributed to the capital of the debtor corporation by X or anyone else. Consequently, the ratio of debt to contributions to capital is not a factor when the creditor claiming the bad debt deduction owns no stock in the debtor.

In the *Washington Institute* case X owned all the stock of both the debtor corporation and the creditor corporation. In the instant case, Clayton R. Jones owned a minority interest in both the Mexican Corporation and taxpayer. If the doctrine of alter ego or notice had any applicability where the creditor owns no stock in the debtor, it would certainly have been applied in the *Washington Institute* case, but the Tax Court recognized the creditor corporation as a separate entity, and held that the record did not substantiate the government's contention that the advances were contributions to capital.

The taxpayer corporation in the *Washington Institute* case made the original advances to the debtor corporation, while taxpayer in the instant case received the 32 notes by assignment. This distinction is immaterial since appellants concede that taxpayer paid value for the notes, and the funds advanced by Clayton R. Jones were received from taxpayer.

III. Supplemental Argument that Record Sustains Conclusion of District Court.

- A. If the stock ownership of Clayton R. Jones in the Mexican Corporation, or his activities in regard thereto, are attributable to taxpayer, then the findings of fact of the District Court (set forth in this brief under the heading "Supplemental Facts") support the conclusion that the notes of the Mexican Corporation constituted debt obligations justifying taxpayer's bad debt deduction.

(1) *The Intent of the Parties Controls.*

The law to be applied is that established by this Court in the *Wilshire* case, *supra*, wherein this Court stated (175 F. 2d 720 and 721):

"It is not contended that a corporation is without power to enter into a debtor and creditor relationship with its stockholders. The intent of the parties as to the nature of the transaction controls.

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"The effect of a lending and investing transaction giving creditors, as stockholders, proprietary interest in proportion to their loans, subjects the transaction to close scrutiny, but does not, as a matter of law, require the transaction to be treated as a stock investment, regardless of intent."

While the *Wilshire* case involved the deductibility of interest, the same law applies to the deductibility of bad debts. This is illustrated by the decision of the Circuit Court of Appeals for the Second Circuit in the recent bad debt case of *Matthiessen et al. v. Commissioner*, 52-1 U.S.T.C. Par. 9201 (C.C.A. 2nd, 1952), wherein the Court cites the *Wilshire* case as follows:

"The question as to whether or not advances to a corporation by the principal stockholder or stockholders are actually contributions to capital or loans is not new. It is essentially a question of fact upon which the taxpayer has the burden of establishing his right to such deduction (*White v. U. S.*, 305 U.S. 281 at 294). The status and nature of the transactions when they occurred is the ultimate question to be decided, and the determinative intent (*Wilshire v. Commissioner*, 175 Fed. (2d) 718), is arrived at by the consideration of relevant facts. "Bookkeeping, form, and the parties' expression of intent or character, the expectation of repayment, the relation of advances to stockholdings, and the adequacy of the corporate capital previously invested are among circumstances properly to be considered, for the parties' formal designation of the advances are not conclusive"

The District Court applied the correct law and subjected the transaction to close scrutiny, as indicated by the following quotation from Conclusion of Law V (R. 65):

"To determine whether advances in any particular instance should be regarded for tax purposes as constituting debts or contributions to capital it is necessary to consider all of the circumstances, including the intent of the parties at the time the transactions in question were entered into"

Perhaps it was unnecessary for the District Court to have applied the close scrutiny specified in the *Wilshire* case, since that case, and the cases therein cited, involved situations where advances were made by *all* the stockholders in direct proportion to their stockholdings. As stated by the District Court (Finding XXXI, R. 62) the advances to the Mexican Corporation were

not made by the stockholders thereof in direct proportion to their stock ownership because Kroder and Johnson owned 20 per cent of the capital stock and made no advances whatsoever to the corporation.

In any event, the District Court did carefully consider all the circumstances, including the intent of the parties at the time the transactions in question were entered into. The only remaining question under taxpayer's supplemental argument is whether the District Court was clearly erroneous in finding the requisite intent to substantiate the bad debt deduction.

(2) Evidence of Intent—Written Agreements.

What better indication or expression of intent can there be than the written agreements under which the advances were made and pursuant to which the notes in question were issued? Such agreements are set forth in Exhibits 53, 57 and 59 (R. 258, 290 and 300, respectively). The basis of the Mexican venture was the mining option agreement (Exhibit 53). Paragraph 4 of this agreement (R. 260) relates that the parties contemplated organization of a Mexican corporation to take over the mining property and that the moneys to be provided by Jones and Higgins "shall be in the form of a loan to said corporation represented by notes of the corporation and repayable within two years from their date"

Instead of forming a new corporation as anticipated when the above mentioned agreement was entered into, the parties acquired an existing dormant Mexican cor-

poration. Exhibit 57 is an agreement dated November 20, 1944, between the activated Mexican Corporation and Jones, Higgins and Harris. This agreement makes it crystal clear that the advances of Jones, Higgins and Harris were to constitute loans. It is difficult to imagine a more precise expression of intent than that set forth in this agreement (R. 290, and quoted on pages 11 through 14 of appellants' brief). For example, paragraph (d) reads as follows (R. 293):

“(d) All monies advanced or expended by First Parties for any of the purposes described in Clauses (a) and (b) above, together with the amounts representing the reasonable purchase price and value to the Company of the mining and milling equipment sold and delivered to the Company as stated in Clause (c) above, together with interest thereon in accordance with the terms above stated, shall become obligations of the Company from the dates when such monies were advanced or expended and from the dates of delivery to the Company of the aforesaid equipment, and the Company shall be and remain indebted under open account for the aforementioned amounts and interest thereon as aforesaid to the respective persons who advanced or expended the monies or who sold and delivered the equipment, until such persons shall have been reimbursed by the Company therefor or until the Company shall have executed and delivered to such persons its note or notes therefor as above provided.”

At a meeting held on November 20, 1944, the board of directors of the Mexican Corporation adopted resolutions specifically confirming the terms of the above mentioned agreement. The minutes of this meeting (Exhibit 58, R. 295) reiterate that the advances of Jones, Higgins and Harris shall constitute loans. Likewise, the

agreement of March 1945 (Exhibit 59, R. 300) between Jones, Higgins and Harris states that all contributions of the parties, except the amount thereof required to pay up the 5,000 pesos capital stock of the Mexican Corporation, shall be regarded as loans to the corporation, to be represented by notes of the corporation, and that said notes shall be payable either at or before their maturity before any dividends shall be declared by the corporation.

In view of the unequivocal expression of intent contained in these agreements, substantiated by the testimony of Jones and Higgins, the District Court had no alternative but to find the requisite intent. How then can the finding of such intent be so clearly erroneous as to justify reversal of the District Court?

Appellants contend that such clear intent is nullified because the agreements provide that the advances of Jones, Higgins and Harris shall be made in proportion to their stockholdings. Such contention is directly contrary to the law set forth in the *Wilshire* case that advances in proportion to stockholdings do not as a matter of law require the advances to be treated as a stock investment, regardless of intent. The intent controls.

(3) *Business purpose for making loans rather than contributions to capital.*

A strong indication of intent is set forth in Finding XXXII (R. 62) of the District Court that there were business reasons why Jones, Higgins and Harris intended that the advances to the Mexican Corporation should constitute loans, in that they desired to be repaid such

advances before anything was received by or accrued to the finders (Kroder and Johnson), who paid nothing for their 20 per cent stock interest, and they desired to be in as strong a position as possible in the event that the Mexican authorities or general creditors made claims against the corporation. The business purpose set forth in this finding is the reason why the above mentioned agreements (Exhibits 53, 57 and 59) so meticulously provided that the advances should constitute loans rather than contributions to capital.

Appellants seek to nullify the above finding of business purpose by suggesting that the interest of the finders could have been handled through the issuance of preferred stock rather than notes. Counsel for taxpayer knows of no doctrine, and appellants suggest none, which requires that preferred stock must be issued rather than debt obligations where business reasons preclude the issuance of common stock. If business reasons make it infeasible to issue common stock, a corporation should have the option of issuing notes rather than preferred stock, and the notes should be recognized for tax purposes.

In any event, the issuance of preferred stock by the Mexican Corporation would not have accomplished one of the objectives sought by Jones, Higgins and Harris, which was to be in as strong a position as possible in the event that the Mexican authorities or general creditors made claims against the corporation. As set forth in Mr. Higgins' testimony (R. 154-156), Jones and Higgins desired to participate with other creditors, and to have a creditor position in the event the Mexican author-

ities made claims against the corporation. Such business purpose would not have been satisfied by the issuance of preferred stock.

Appellants' brief makes considerable mention of the fact that the Mexican law required new corporations to be 51 per cent owned by Mexican citizens. Appellants have obtained the erroneous impression that a desire to circumvent this Mexican law was the motivating factor behind the issuance of the notes. The testimony of Higgins (R. 154 and 155) discloses that there was an uncertainty whether an increase in the capital stock of an existing Mexican corporation would fall within this law. Such uncertainty in the Mexican law was merely one of the elements taken into consideration. The testimony as a whole makes it perfectly clear that the desire to be in a position to share with general creditors (R. 155, 140-141), to be in as strong as possible position with Mexican authorities (R. 155-156), and the desire to take precedence over the finders (R. 135-137) were the reasons for making loans, rather than contributions to capital. In its findings the District Court does not even mention this uncertainty in the Mexican law as one of the reasons for the issuance of the notes. It seems obvious that the above mentioned agreements (Exhibits 53, 57 and 59) were not drafted for the sole purpose of overcoming an uncertainty in the Mexican law, but were drafted to accomplish the abovementioned objectives.

(4) *Other evidence of intent.*

The findings are replete with other indications of intent, such as Finding XXXIII (R. 63) that Jones, Hig-

gins and Harris expected the advances required by the Mexican Corporation would not exceed \$50,000. They believed that the loans would be repaid prior to the maturity dates of the notes issued for such loans, and based on their investigations, available engineering reports and blocked-out ore deposits, such belief was reasonable. The liabilities evidenced by the notes were agreed to be incurred by Jones, Higgins and Harris in the expectancy that the Mexican Corporation would be successful and pay off the obligations. The foregoing findings are amply supported by testimony (R. 97-99, 121-123, 134-135, 144-145).

Another indication of intent is contained in Finding XXXIV (R. 63) of the District Court that the loans were consistently treated as loans and debt obligations on the books of the taxpayer and on the books of the Mexican Corporation. A concrete example of intent is the fact that taxpayer accrued interest on the notes for 1946-1948 which interest was reflected in taxpayer's income for federal income tax purposes (Finding XVIII, R. 58).

(5) *Decisions sustaining debts.*

As previously noted, whether a debt exists for tax purposes is a question of fact to be determined by the trial court upon a consideration of all the facts. Taxpayer believes that there is nothing to be gained by a review of the decisions of other courts involving varying fact situations. Suffice it to point out that in the following comparatively recent bad debt cases (in addition to those mentioned elsewhere in this brief) the trial court

sustained the existence of a debt for tax purposes in spite of stock ownership in proportion to the debt, and in none of these cases were there as strong indications of intent as the agreements pursuant to which the notes of the Mexican Corporation were issued (Exhibits 53, 57 and 59) and the business purpose discussed above: *Lucia Chase Ewing*, P-H T.C. Memo. Dec. Par. 46,235 (1946); *Arthur V. McDermott*, 13 T.C. 468 (1949); *Valentine E. Macy, Jr.*, P-H T.C. Memo. Dec. Par. 49,009 (1949); *Alma de Bretteville Spreckels*, P-H T.C. Memo. Dec. Par. 49,299 (1949); *Ethel S. White*, P-H T.C. Memo. Dec. Par. 47,262 (1947). Also debt obligations were recognized in the following interest deduction cases: *New England Lime Company*, 13 T.C. 799 (1949); *The Toledo Blade Company*, 11 T.C. 1079 (1948); *250 Hudson Street Corporation*, P-H T.C. Memo. Dec. Par. 46,205 (1946); *The Tribune Publishing Company*, 17 T.C. No. 148 (1952); *H. E. Fletcher Co.*, P-H T.C. Memo. Dec. Par. 51,317 (1951); *Sabine Royalty Corp.*, 17 T.C. No. 130 (1951); *Lansing Community Hotel Corporation*, 14 T.C. 183 (1950), affirmed, 187 F. 2d 487 (C.C.A. 6th, 1951).

B. Consideration of features which appellants contend militate against recognition of the notes as debt obligations.

(1) *Advances in proportion to stockholdings.*

Appellants emphasize the fact that the advances evidenced by the notes were made in proportion to stockholdings. As stated above, the advances to the Mexican Corporation were not made by all the stockholders in proportion to stock ownership because Kroder and John-

son owned 20 per cent of the capital stock but made no advances whatsoever to the corporation. In any event, the District Court has closely scrutinized the transactions as required by the *Wilshire* case, and has determined that upon a consideration of all the circumstances, including the intent of the parties at the time the transactions were entered into, the notes were debt obligations within the meaning of I.R.C. Section 23 (k).

(2) *Ratio of debt to capital.*

Appellants contend that the ratio of debt to capital constitutes a feature militating against recognition of the notes as debt obligations. The amount of the debt was slightly in excess of \$308,000. What were the total contributions to capital? The \$1,000 paid to the corporation for the capital stock was for the purpose of complying with the Mexican law requiring that the capital stock be paid up. The real contribution to capital was the transfer of the mining rights to the corporation. Exhibit 53 (R. 258) indicates that Jones, Higgins and Harris acquired the option to the mining rights from Kroder in the form of an option of purchase. Jones, Higgins and Harris transferred the option to the Mexican Corporation (R. 88) and the corporation acquired the mining rights represented by Exhibit 56 (R. 269). As found by the District Court (Finding XXVIII, R. 61) such mining rights at the time of transfer by the Mexican Corporation to Jones, Higgins and Harris had a very substantial value in excess of the amount payable under the option and lease agreement, and such transfer of the mining rights constituted contributions to the capital of the Mexican Corporation by Jones, Higgins and Harris.

The transfer of such mining rights to the Mexican Corporation was not formally capitalized by the issuance of stock having a par value equal to the value of the mining rights. The failure to issue stock for the mining rights does not make such transfer any the less a contribution to capital. Mr. Jones testified as follows on cross examination (R. 105-106):

“Q. So, the \$1,000 paid in for the stock was the whole capital invested at the beginning, wasn't it?

A. No, sir.

Q. What else was invested?

A. There was a mining value in the prospects of that mine that in my opinion had a minimum value of \$50,000 and could run up into hundreds of thousands, due to the fact that those veins showed such excellent progress at that time . . . ”

In the cases of *Maloney v. Spencer* and *Washington Institute of Technology*, supra, contracts were transferred by the respective taxpayers to the debtor corporations in return for all the capital stock of the respective corporations. Such stock had a substantial par value, but the transfers would have been none the less contributions to capital if the taxpayers had received in exchange therefor no-par stock or stock having an aggregate par value of \$1,000. To hold that the validity for tax purposes of contributions to capital depends upon the issuance of stock having substantial par value would be a sacrifice of substance for form which is so abhorred by appellants.

If any significance is to be attached to the Mexican law which cast doubt on the validity of issuing newly created stock to aliens, such law affords a reason why

the Mexican Corporation did not formally capitalize the mining rights by issuing additional stock to Jones, Higgins and Harris.

The District Court not only found that the transfer of the mining rights to the Mexican Corporation by Jones, Higgins and Harris constituted contributions to capital, but also found that the mining rights at the time of such contributions to capital had a very substantial value in excess of the amount payable under the option and lease agreement. Very positive proof of such value is afforded by the fact that within six months after such contribution a third person paid \$5,000 for a 10 per cent stock interest in the Mexican Corporation (Finding XXIX, R. 61). This would indicate that a 100 per cent stock interest in the Mexican Corporation was worth at least \$50,000. The only asset accounting for such value of the stock was the excess in the value of the mining rights over the amounts payable under the option and lease agreement. As a general rule a purchaser will pay less than one-tenth as much for a 10 per cent stock interest as he would for a 100 per cent stock interest.

Consequently, \$50,000 is a low estimate of the value of the mining rights contributed to the Mexican Corporation by Jones, Higgins and Harris. Mr. Jones testified that such value could have run up into hundreds of thousands (R. 105-106). It seems more reasonable to attribute a value of \$100,000 to the mining rights. In short, Jones, Higgins and Harris contributed a minimum of \$51,000 and probably \$101,000 or more to the capital of the Mexican Corporation. On the basis

of the foregoing the ratio of debt to capital was no higher than six to one, and probably three to one or less.

In the case of *John Kelley Co. v. Commissioner*, 326 U.S. 521 (1946) the Supreme Court stated that material amounts of capital had been invested so that it was not necessary to consider the effect of extreme situations such as nominal stock investments and obviously excessive debt structure. The ratio of debt to capital in the Kelley case was four to one. As stated above, the ratio of the Mexican Corporation was probably three to one or less and was no more than six to one. Even a ratio of six to one is not so much greater than four to one as to constitute an extreme situation, particularly in view of the fact that Jones, Higgins and Harris expected that the advances required by the Mexican Corporation would not exceed \$50,000 and had no idea that the advances would exceed \$300,000. They fully expected that the venture would stand on its own feet and commence repayment after advances of not to exceed \$50,000.

The contributions to capital of the Mexican Corporation were more substantial than the contributions to the capital of the corporations involved in the *Maloney* case, *supra*. The decision in the *Maloney* case attributes no value to the contracts transferred in return for all the capital stock. The ratio of debt to capital is only one of a number of factors to be considered and is not pertinent where there are other strong indications of the requisite intent. For this reason it was unnecessary in the *Maloney* case for either the District Court or this Court to discuss the ratio of debt to capital. Likewise,

there are no grounds for reversal of the District Court here even if it should be determined that the ratio of debt to capital of the Mexican Corporation was 300 to one, but as stated above the ratio was probably three to one or less, and not more than six to one.

(3) *Miscellaneous contentions of appellants.*

Appellants suggest that some significance should be attached to the fact that the stock of the Mexican Corporation was actually issued after the advances were made. In the *Wilshire* case, *supra*, both the stock and the notes were issued after the advances were made.

That any adverse inference should be drawn from the fact that Jones, Higgins and Harris failed to demand payment of the notes immediately when due is conclusively answered by the following statement of this Court in the *Wilshire* case (175 F. 2d pp. 720-721):

“Under the circumstances no adverse inference should be drawn from the failure of the stockholders to demand payment immediately when due. The same strict insistence on payment on due date as would be the case if a bank were the creditor, should not be expected.”

Likewise, no adverse inference should be drawn from the fact that upon liquidation of the Mexican Corporation Jones and Higgins paid off the liabilities of the Mexican Corporation without asserting their full rights as creditors under the notes.

The provision in the agreements that the notes shall be paid before any dividends may be declared on the

stock is a very common provision contained in loan agreements and indentures under which debt obligations are issued. Such provision would seem to be evidence of a debt obligation, rather than evidence to the contrary as suggested by appellants (B. 46).

(4) *No tax motive for the loans.*

Appellants' brief is resplendent with statements which suggest that the actions of Jones and Higgins constituted a "wholly useless temporary compliance with statutory literalness" (Br. 53) for the purpose of "depriving the United States of taxes" and to "disguise the true nature of a deduction claim" (Br. 32). Appellants further suggest that in some way the Internal Revenue Code is being "misread to subject the amount of tax liability to the substantially untrammelled control" of taxpayer (Br. 35) in such manner that "the intent of Congress would most facilely and flagrantly be obviated and the statute nullified by the mere passing of papers" (Br. 54).

Taxpayer trusts that such statements are not indicative of the sincerity with which appellants present their other arguments, because such inferences are wholly and obviously unfounded. There could have been no federal tax motive whatsoever for making advances to the Mexican Corporation in the form of loans rather than contributions to capital. The Mexican Corporation was not subject to federal income tax, so it made no difference whether or not interest was deductible on the advances. Notes gave no more tax benefit than stock.

If Jones and Higgins thought the likelihood of taking a loss was sufficient to warrant the drafting of the agree-

ments (Exhibits 53, 57 and 59) and issuance of the notes, they certainly would not have advanced the money in the first place. Furthermore, the decision to advance the funds in the form of loans rather than contributions to capital was made by Higgins as much as by Jones, and Higgins claimed no bad debt deduction for the more than \$150,000 he lost in the venture. It made no difference to Higgins whether the notes were debt obligations or not since he sold his notes after they became worthless (R. 145-150).

Taxpayer submits that one, and only one, of the following propositions is true:

1. While optimistically advancing funds for the exploitation of a mining venture which at the time promised to be a bonanza, Jones and Higgins meticulously prepared agreements and issued notes primarily for tax reasons, although no tax consequence could possibly materialize from such agreements and notes unless the advances became worthless.

2. There was more than the "mere passing of papers" suggested by appellants, and for reasons other than tax considerations the parties really intended that the advances to the Mexican Corporation should constitute loans rather than contributions to capital.

The District Court was not clearly erroneous in determining that the second proposition is correct.

CONCLUSION

Taxpayer respectfully submits that the 32 notes of the Mexican Corporation were what they purported to be, and the judgment of the District Court should be affirmed because: (i) taxpayer owned no stock or other equity interest in the Mexican Corporation, so it is impossible to consider the 32 notes as adjuncts of a stock or equity interest; and (ii) in any event, the District's Court's conclusion that the 32 notes constituted debt obligations is not clearly erroneous, the District Court having correctly subjected the transactions to the close scrutiny required by the *Wilshire* case.

Respectfully submitted,

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